

# Solvency and Financial Condition Report

**31 December 2018**



## **Lloyd's Solvency and Financial Condition Report – 31 December 2018**

### Overview

Lloyd's Solvency and Financial Condition Report (SFCR) as at 31 December 2018 has been prepared in accordance with Article 51 of the Solvency II Directive (2009/138/EC), Articles 290 to 298 of the Commission Delegated Regulation (EU) 2015/35, and Section 3 of the PRA Rulebook Solvency II Firms: Reporting Instrument 2015.

This SFCR is prepared in respect of 'the association of underwriters known as Lloyd's' ('Lloyd's'), the supervised undertaking as referred to in Annex III of Directive 2009/138/EC. Further information on the structure of Lloyd's, and the basis of preparation of the SFCR, is described in the Summary.

Lloyd's SFCR contains the quantitative templates as specified by the Commission Delegated Regulation (EU) 2015/2452.

### Further information

Additional information regarding Lloyd's may be found within Lloyd's Annual Report 2018 and Aggregate Accounts 2018. These reports are available from Lloyd's website: <https://www.lloyds.com/investor-relations/financial-performance/financial-results/annual-report-2018>

The Lloyd's Annual Report includes the Pro Forma Financial Statements (PFFS), which are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared as closely as possible with general insurance companies. The PFFS have been prepared by aggregating audited financial information reported in syndicate returns and annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's (the Society). The Annual Report also includes the financial statements of the Society of Lloyd's, comprising the financial position and performance of the Corporation of Lloyd's and the Central Fund.

The Aggregate Accounts set out an aggregation of all audited syndicate annual accounts including the audited results for calendar year 2018 and the financial position as at 31 December 2018 of all syndicates which transacted business during 2018.

Where relevant, references to these documents are made in the SFCR.

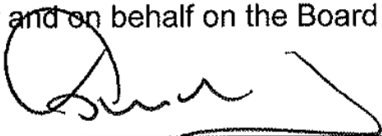
## Governing body's statement in respect of the SFCR

We, the Board, acknowledge our responsibility for preparing the SFCR of Lloyd's as at 31 December 2018 in all material respects in accordance with the PRA Rules and Solvency II Regulations as applicable to Lloyd's.

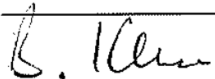
We are satisfied that:

- a) throughout the financial year in question, Lloyd's has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable to Lloyd's; and
- b) it is reasonable to believe that Lloyd's has continued so to comply and will continue so to comply in future.

For and on behalf on the Board

---

---

John Neal, Chief Executive Officer

Burkhard Keese, Chief Financial Officer

16 April 2019

## Contents

Section	Content	Page
	<b>Summary</b>	6
<b>A</b>	<b>Business and performance</b>	16
A.1	- Business	16
A.2	- Underwriting performance	18
A.3	- Investment performance	19
A.4	- Performance of other activities	20
A.5	- Any other information	20
<b>B</b>	<b>System of governance</b>	21
B.1	- General information on the system of governance	21
B.2	- Fit and proper requirements	28
B.3	- Risk management system including the own risk and solvency assessment	29
B.4	- Internal control system	33
B.5	- Internal audit function	34
B.6	- Actuarial function	36
B.7	- Outsourcing	37
B.8	- Any other information	38
<b>C</b>	<b>Risk profile</b>	39
C.1	- Underwriting risk	40
C.2	- Market risk	42
C.3	- Credit risk	43
C.4	- Liquidity risk	43
C.5	- Operational risk	44
C.6	- Other material risks	44
C.7	- Any other information	47
<b>D</b>	<b>Valuation for solvency purposes</b>	48
D.1	- Assets	49
D.2	- Technical provisions	52
D.3	- Other liabilities	57
D.4	- Alternative methods for valuation	59
D.5	- Any other information	59
<b>E</b>	<b>Capital management</b>	60
E.1	- Own funds	60
E.2	- Solvency Capital Requirement and Minimum Capital Requirement	71
E.3	- Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement	73
E.4	- Differences between the standard formula and any internal model used	73
E.5	- Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement	78
E.6	- Any other information	78
Appendix 1	<b>Quantitative reporting templates</b>	
Appendix 2	<b>Report by PricewaterhouseCoopers LLP</b>	

## Summary

### What Lloyd's is

Lloyd's is the world's leading insurance and reinsurance marketplace. Through the collective intelligence and risk-sharing expertise of the market's underwriters and brokers, Lloyd's helps to create a braver world.

The Lloyd's market provides the leadership and insight to anticipate and understand risk, and the knowledge to develop relevant, new and innovative forms of insurance for customers globally.

It offers the efficiencies of shared resources and services in a marketplace that covers and shares risks from more than 200 territories, in any industry, at any scale.

And it promises a trusted, enduring partnership built on the confidence that Lloyd's protects what matters most: helping people, businesses and communities to recover in times of need.

Lloyd's began with a few courageous entrepreneurs in a coffee shop. Three centuries later, the Lloyd's market continues that proud tradition, sharing risk in order to protect, build resilience and inspire courage everywhere.

Lloyd's writes a wide range of classes of business in a variety of geographical areas. This is highlighted in the below table which provides a Lloyd's class breakdown of gross written premium by region:

2018

	US and Canada	Other Americas	United Kingdom	Rest of Europe	Central Asia & Asia Pacific	Rest of the World	Total for all Regions
Reinsurance	22%	67%	31%	30%	43%	63%	31%
Property	36%	9%	26%	19%	19%	9%	27%
Casualty	28%	14%	25%	26%	28%	11%	26%
Marine	6%	7%	6%	16%	6%	6%	7%
Energy	5%	1%	2%	4%	2%	4%	4%
Motor	2%	1%	9%	2%	1%	3%	3%
Aviation	1%	1%	1%	3%	1%	4%	2%
<b>Total GWP</b>	<b>51%</b>	<b>7%</b>	<b>14%</b>	<b>13%</b>	<b>11%</b>	<b>4%</b>	<b>100%</b>

2017

	US and Canada	Other Americas	United Kingdom	Rest of Europe	Central Asia & Asia Pacific	Rest of the World	Total for all Regions
Reinsurance	22%	70%	30%	30%	44%	61%	32%
Property	35%	8%	26%	19%	17%	11%	27%
Casualty	28%	10%	25%	25%	29%	11%	25%
Marine	6%	7%	5%	16%	5%	6%	7%
Energy	5%	2%	2%	4%	2%	3%	4%
Motor	2%	1%	10%	2%	1%	4%	3%
Aviation	2%	2%	2%	4%	2%	4%	2%
<b>Total GWP</b>	<b>50%</b>	<b>6%</b>	<b>15%</b>	<b>14%</b>	<b>10%</b>	<b>5%</b>	<b>100%</b>

## Lloyd's Market Structure

### Members – providing the capital

The capital to underwrite policies is provided by members of Lloyd's. This capital is backed by many of the world's major insurance groups, listed companies, individuals and limited partnerships, with corporate groups providing the majority of the capital for the Lloyd's market.

### Syndicates – writing the insurance

A Lloyd's syndicate is formed by one or more members joining together to provide capital and accept insurance risks. Most syndicates write a range of classes of business, but many will have areas of specific expertise. Syndicates are, technically, set up on an annual basis. In practice, they usually operate from year to year with members having the right, but not the obligation, to participate in syndicates the following year. This continuity of capital backing the syndicates means they function like permanent insurance operations. Each syndicate sets its own appetite for risk, develops a business plan, arranges its reinsurance protection and manages its exposures and claims.

At 31 December 2018 there were 99 active (i.e. participating in the 2019 year of account) syndicates at Lloyd's.

### Managing agents – managing the syndicates

A managing agent is a company set up to manage one or more syndicates on behalf of the members. Managing agents have responsibility for employing underwriters, overseeing their underwriting and managing the infrastructure and day-to-day operations.

At 31 December 2018 there were 55 managing agents at Lloyd's.

### Policyholders – transferring risk

Policyholders include businesses, organisations, other insurers and individuals from around the world who seek to mitigate the impact of potential risks. Policyholders may access the Lloyd's market via a broker, coverholder or service company.

### Brokers – distributing business

Lloyd's is a broker market in which strong relationships, backed by deep expertise, play a crucial part. Brokers facilitate the risk transfer process between policyholders and underwriters. Much of this business involves face to face negotiations between brokers and underwriters.

At 31 December 2018 there were 303 broking firms introducing business to Lloyd's.

### Coverholders – offering local access to Lloyd's

A managing agent may also authorise third parties to accept insurance risks directly on behalf of its syndicates. These businesses, known as coverholders, form a vital distribution channel, offering a local route to Lloyd's in many territories around the world.

At 31 December 2018 there were 3,936 approved coverholder office locations.

### Service companies

A service company operates like a coverholder but is a wholly owned subsidiary of either a managing agent or of a managing agent's holding company and which is

authorised to enter into contracts of insurance for members of its associated syndicate and/or associated insurance companies.

At 31 December 2018 there were 378 service companies at Lloyd's, with the majority in the UK and the US.

#### Members' agents – supporting the members

Members' agents provide advice and administrative services to members, including assisting with syndicate selection.

At 31 December 2018, there were three members' agents at Lloyd's.

#### Corporation of Lloyd's – supporting the market

The Corporation oversees the Lloyd's market. It provides the market's infrastructure, including services to support its efficient running, and protects and maintains its reputation.

The Corporation's role includes:

- managing and protecting Lloyd's network of international licences;
- agreeing syndicates' business plans and evaluating performance against those plans. Syndicates are required to underwrite only in accordance with their agreed business plans. If they fail to do so, Lloyd's can take a range of actions including, as a last resort, stopping a syndicate underwriting;
- monitoring syndicates' compliance with Lloyd's minimum standards; and
- continuing to raise standards and improve performance across two main areas:
  - overall risk and performance management of the market; and
  - maintaining and developing the market's attractiveness to capital providers, distributors and clients, while preserving its diversity.

The Corporation's Executive Committee exercises the day-to-day powers and functions of the Council of Lloyd's and the Franchise Board ('the Board').

At 31 December 2018 the Corporation and its subsidiaries had 1044 staff.

#### Financial highlights

Lloyd's incurred a loss of £1,001m (2017: loss of £2,001m) based on gross written premium of £35,527m for the year (2017: £33,591m), summarised as follows:

	2018	2017
	£m	£m
Underwriting result	(1,130)	(3,421)
Investment return	504	1,800
(Loss)/profit on exchange	(8)	(62)
Other income	33	42
Expenses (other than technical account operating expenses)	(400)	(360)
<b>Total</b>	<b>(1,001)</b>	<b>(2,001)</b>

The Lloyd's market reported a combined ratio of 104.5% (2017: 114.0%), which represents a return on capital of (3.7%) (2017: (7.3%)).

This result is driven by the losses arising from a number of catastrophic events which impacted the insurance industry in the second half of 2018, notably Hurricanes



Florence and Michael and the wildfires in California, and lower investment returns generated in the tough investment market conditions.

2018 was the second successive year of significant catastrophic losses for the insurance industry and so too the Lloyd's market. Insured losses arising from catastrophic events cost the Lloyd's market £2.9bn, net of reinsurance, in 2018 (2017: £4.5bn) and added 11.6% to the combined ratio (2017: 18.5%). The impact of these major events on the Lloyd's market result was offset to some extent by prior year releases of £976m (2017: £706m), representing a 3.9% (2017: 2.9%) improvement to the combined ratio.

During 2018 stable or increased pricing levels became more widespread as the year progressed after many years of decline; favourable price movements were seen across all lines of business and more notably in those which had the greatest exposures to the major catastrophic events in 2017. The Lloyd's market experienced a weighted average increase in prices on renewal business slightly over 3% in 2018. In addition, several syndicates exited or severely curbed their risk appetites in poor-performing lines, as Lloyd's began to ramp up its activity to support the market in closing the performance gap.

The market's investments generated a return of £504m (2017: £1,800m), or 0.7% (2017: 2.7%), showing some reduction on the previous year and also well below the five-year average. Syndicate investments returned £333m (0.8%), the notional investment return on members' capital was £178m (0.7%) and the investment return on Lloyd's central assets was a loss of £7m (-0.2%). In terms of key drivers, an allocation, albeit conservative, to equity and risk assets generated losses for the year but this was more than offset by positive returns in cash, government and investment grade corporate bonds.

As at 31 December 2018, Lloyd's net total resources – capital, reserves and subordinated loan notes – amounted to £28,222m (31 December 2017: £27,560m). Central assets amounted to £3,211m (31 December 2017: £2,981m). Lloyd's ratings remain at A+ (strong) with Standard and Poor's, AA- (very strong) with Fitch Ratings, and A (excellent) with A.M. Best.

#### Lloyd's risk profile

At Lloyd's, the risk profile originates from both syndicates and at central level.

Syndicates are the source of the majority of risks. They source all the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the day-to-day operational activity. The syndicate risks include: insurance risk (underwriting, reserving and catastrophe risk); market risk on syndicate assets (including credit risk on Premiums Trust Funds (PTF)); reinsurance and other credit risk; and syndicate operational risk.

At the central level, additional risks arise from central operational risk, pension fund risk; market risk on central assets; and the risk of member default.

#### Solvency Capital Requirement (Solvency II basis)

The Solvency Capital Requirement (SCR) represents the amount of capital required to withstand 1 in 200 year losses over a one year time horizon. Given Lloyd's unique structure there are two SCRs which are monitored under the Solvency II regime:

- The Lloyd's market wide SCR (MWSCR) is calculated to cover all the risks of 'the association of underwriters known as Lloyd's', i.e. those arising on

syndicate activity, members' capital provided at Lloyd's and the Society taken together, at a 99.5% confidence level over a one-year time horizon as provided for in Solvency II legislation. All the capital of the component parts of the market taken together is available to meet the MWSCR.

- The Lloyd's central SCR (CSCR) is calculated in respect of only the risks facing the Society and the Central Fund at the same confidence level and time horizon used to calculate the MWSCR. The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with Lloyd's rigorous capital setting rules.

Individual syndicates are also required to calculate a SCR, at a 99.5% confidence level over a one-year horizon, for each underwriting year; this drives the determination of member level SCRs. Each member's SCR is derived as the sum of the member's share of the syndicate's one-year SCR. Where a member participates on more than one syndicate, a credit for diversification is provided to reflect the spread of risk. The MWSCR and CSCR are derived from the Lloyd's Internal Model which has been approved by the PRA. Individual syndicates also derive SCRs from their own internal models which are subject to approval by the Lloyd's Capital and Planning Group. The appropriateness of each syndicate's internal model, including changes thereto and the reasonableness of the key assumptions are assessed as part of the Corporation's oversight of the Lloyd's market.

#### Lloyd's Internal Model

The approved Lloyd's Internal Model (LIM) is a purpose-built model designed to calculate the MWSCR and CSCR as required under Solvency II. It covers all risk types and all material risks for the aggregation of syndicates as well as for the Corporation, allowing for the unique capital structure of Lloyd's. The LIM consists of three main components: the Lloyd's Investment Risk Model (LIRM) which simulates economic variables and total assets returns; the Lloyd's Catastrophe Model (LCM) which models catastrophe risk; and the Capital Calculation Kernel (CCK) which is the main element of the LIM where all other risks are simulated, and all risks are combined.

Syndicates calculate their own SCR however the market wide and central capital requirements are derived from Lloyd's parameterisation at a whole market level to build a view of total market capital requirements from the ground up using market level assumptions. The LIM uses a methodology whereby losses from insurance and other risks are simulated by class of business, allocated to syndicates and through to members to assess the level of capital required by the market and centrally to meet 1 in 200-year losses over the one-year time horizon.

#### Lloyd's solvency ratios and capital

Lloyd's solvency position is summarised below:

	Dec 2018	Dec 2017
	£m	£m
Market wide solvency		
Lloyd's MWSCR	17,750	16,950
Eligible capital	26,239	24,381
Lloyd's solvency ratio	148%	144%
Central solvency		
Central SCR	1,400	1,600
Eligible central capital	3,493	3,445
Lloyd's central solvency ratio	249%	215%

The market wide solvency ratio at 31 December 2018 is 148% (2017: 144%). The solvency ratio has improved over 2018, notwithstanding the severe losses incurred across the Lloyd's market in relation to the US and Asian windstorms and Californian wildfires in the second half of 2018. This is due a reduction in the amount of ineligible Tier 2 capital due to progressive restrictions on the proportion of Tier 2 capital (letters of credit and bank guarantees) that members can provide, which were introduced during 2018.

The central solvency ratio has improved over this period as a result of the reduction in the central SCR. The central SCR has reduced following an increase in member level capital levels set by Lloyd's, so moving the Central Fund 'further away' from exposure to member level underwriting losses.

A summary of Lloyd's market wide capital ('own funds') by tier is set out below.

31 December 2018	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate net assets	(2,750)			(2,750)
Members' funds at Lloyd's (FAL)	18,471	7,656		26,127
Society assets:				
Subordinated debt		822		822
Deferred tax			31	31
Balance of net assets	2,009			2,009
<b>Total own funds available to meet the SCR</b>	<b>17,730</b>	<b>8,478</b>	<b>31</b>	<b>26,239</b>
<b>Lloyd's SCR*</b>				<b>17,750</b>
'Excess' own funds not eligible to meet SCR	-	-	-	-
<b>Total own funds eligible to meet the SCR</b>	<b>17,730</b>	<b>8,478</b>	<b>31</b>	<b>26,239</b>
<b>Lloyd's solvency ratio</b>				<b>148%</b>

31 December 2017	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate net assets	(1,106)			(1,106)
Members' funds at Lloyd's (FAL)	15,125	9,452		24,577
Society assets:				
Subordinated debt		908		908
Deferred tax			25	25
Balance of net assets	1,887			1,887
<b>Total own funds available to meet the SCR</b>	<b>15,906</b>	<b>10,360</b>	<b>25</b>	<b>26,291</b>
<b>Lloyd's SCR*</b>				<b>16,950</b>
'Excess' own funds not eligible to meet SCR	-	1,885	25	1,910
<b>Total own funds eligible to meet the SCR</b>	<b>15,906</b>	<b>8,475</b>	<b>-</b>	<b>24,381</b>
<b>Lloyd's solvency ratio</b>				<b>144%</b>

The eligibility of assets to count towards the solvency coverage is subject to tiering restrictions. All Tier 1 assets count fully towards the solvency coverage assessment. However, Tier 2 and Tier 3 assets are only eligible up to a maximum of 50% of the SCR. A significant portion of the members' FAL are in the form of letters of credit (LOCs), which are classified as Tier 2 assets under Solvency II. At 31 December 2018 the amount of ineligible Tier 2 and Tier 3 capital was £nil (2017: £1,910m, of which £1,885m was LOCs callable on demand).

These LOCs are callable on demand and when called, the proceeds, namely cash, would qualify as Tier 1 assets. Under these circumstances, any amounts previously restricted would become fully eligible.

The central own funds available to cover the central SCR are summarised below:

31 December 2018	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Society net assets:				
Subordinated debt		822		822
Deferred tax			31	31
Balance of net assets	2,009			2,009
Callable layer	784			784
<b>Total central own funds available to meet the SCR</b>	<b>2,793</b>	<b>822</b>	<b>31</b>	<b>3,646</b>
<b>Central SCR*</b>				<b>1,400</b>
'Excess' central own funds not eligible to meet central SCR		122	31	153
<b>Total central own funds eligible to meet the SCR</b>	<b>2,793</b>	<b>700</b>	<b>-</b>	<b>3,493</b>
<b>Central solvency ratio</b>				<b>249%</b>

31 December 2017	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Society net assets:				
Subordinated debt		908		908
Deferred tax			25	25
Balance of net assets	1,887			1,887
Callable layer	758			758
<b>Total central own funds available to meet the SCR</b>	<b>2,645</b>	<b>908</b>	<b>25</b>	<b>3,578</b>
<b>Central SCR*</b>				<b>1,600</b>
'Excess' central own funds not eligible to meet central SCR	-	108	25	133
<b>Total central own funds eligible to meet the SCR</b>	<b>2,645</b>	<b>800</b>	<b>-</b>	<b>3,445</b>
<b>Central solvency ratio</b>				<b>215%</b>

#### Callable layer

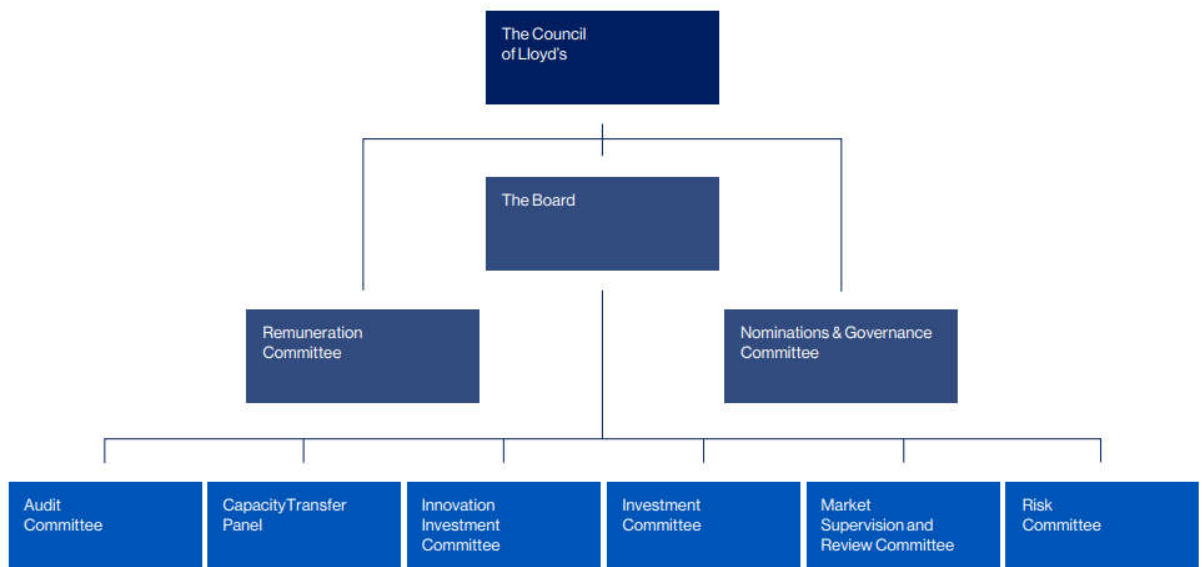
The Society has the right to make a call on members of up to 3% of members' premium limits ("callable contributions"). The callable contributions can be drawn from members' premiums trust funds without the members' consent. This would result in the transfer of Tier 1 capital from syndicate funds to central resources. The value assigned to the callable layer has been reduced to reflect that part of the callable layer which would not be available in a stressed situation at the central SCR level of confidence.

#### Coverage of the central SCR with eligible central own funds

The capital tiering rules also apply to the coverage of the central SCR. Total subordinated debt and deferred tax assets result in Lloyd's Tier 2 and 3 central capital of £853m. Only £700m – 50% of £1,400m - of this is eligible in the solvency calculation.

#### Lloyd's governance structure

The structure of the principal governing bodies of Lloyd's is summarised in the chart below:



### The Council of Lloyd's

Under Lloyd's Act 1982, the Council of Lloyd's undertakes the management and superintendence of the affairs of the Society and has the power to regulate and direct the business of insurance at Lloyd's.

### The Board

The Council established the Board as from 1 January 2003. The Board develops strategies to meet the Corporation Purpose of creating and maintaining a competitive, innovative and secure market.

The Board is responsible for the day-to-day oversight of Lloyd's and thus constitutes Lloyd's Administrative, Management or Supervisory Body (AMSB).

### Basis of preparation of the SFCR

The basis of preparation of the Lloyd's SFCR has been selected so that the financial position of Lloyd's is presented on a basis to most appropriately reflect the structure of Lloyd's.

The SFCR includes the aggregate of returns submitted from syndicates (the relevant 'Lloyd's templates' as referred to in the PRA Rulebook Solvency II Firms: Reporting Instrument 2015' (PRA 2015/23)), members' Funds at Lloyd's (FAL) and in respect of the Society of Lloyd's, including the Corporation and Central Fund.

The Lloyd's templates report the Pillar 3 information for calendar year 2018 and the financial position at 31 December 2018 for all syndicates which transacted business during the year. The data therein which contributes to the audited section of the SFCR is the subject of an audit opinion by the auditor of each syndicate.

The capital provided by members is generally held centrally as FAL. The data included within the SFCR in relation to FAL is provided by the Corporation. The data therein which contributes to the audited section of the SFCR is the subject of a reasonable assurance engagement by PwC as the auditor of Lloyd's.

Data in respect of the Society of Lloyd's is also provided by the Corporation. Again, the data therein which contributes to the audited section of the SFCR is the subject of a reasonable assurance engagement by PwC.

The balance sheet (S.02.01) and summary of own funds (S.23.01) in the SFCR aggregate the assets held at syndicate level, members' assets held as FAL and the central resources of the Society. Overall, the SFCR aggregates the results and resources of the Society and its members. The SFCR may, therefore, be used as a reasonable presentation of the results and state of affairs of the Lloyd's market on a basis that is as closely as possible comparable with general insurance companies.

## A. Business and Performance

### A.1 Business

#### Name and legal form of undertaking

Lloyd's is a society incorporated by the Lloyd's Act 1871, whose principal place of business is at One Lime Street, London EC3M 7HA.

The 'association of underwriters known as Lloyd's' is the legal form of the undertaking as defined in Annex III of the Solvency II Directive (2009/138/EC).

#### Supervisory authority responsible for financial supervision

The supervisory authority of Lloyd's is the Prudential Regulation Authority (PRA), which was created as part of the Bank of England by the Financial Services Act (2012). The registered office of the PRA is as follows:

Prudential Regulation Authority  
8 Lothbury  
London  
EC2R 7HH

#### External auditor of the undertaking

The independent auditors of Lloyd's are:

PricewaterhouseCoopers LLP  
Chartered Accountants  
7 More London Riverside  
London  
SE1 2RT

#### Holders of qualifying holdings of the undertaking

There are no qualifying holdings applicable to Lloyd's.

#### Legal structure of group

Lloyd's does not belong to a group.

#### Material lines of business and geographical areas

Lloyd's writes a wide range of classes of business in a variety of geographical areas. This is highlighted in the below table which provides a Lloyd's class breakdown of gross written premium by region:

2018

	US and Canada	Other Americas	United Kingdom	Rest of Europe	Central Asia & Asia Pacific	Rest of the World	Total for all Regions
Reinsurance	22%	67%	31%	30%	43%	63%	31%
Property	36%	9%	26%	19%	19%	9%	27%
Casualty	28%	14%	25%	26%	28%	11%	26%
Marine	6%	7%	6%	16%	6%	6%	7%
Energy	5%	1%	2%	4%	2%	4%	4%
Motor	2%	1%	9%	2%	1%	3%	3%
Aviation	1%	1%	1%	3%	1%	4%	2%
<b>Total GWP</b>	<b>51%</b>	<b>7%</b>	<b>14%</b>	<b>13%</b>	<b>11%</b>	<b>4%</b>	<b>100%</b>



2017

	US and Canada	Other Americas	United Kingdom	Rest of Europe	Central Asia & Asia Pacific	Rest of the World	Total for all Regions
Reinsurance	22%	70%	30%	30%	44%	61%	<b>32%</b>
Property	35%	8%	26%	19%	17%	11%	<b>27%</b>
Casualty	28%	10%	25%	25%	29%	11%	<b>25%</b>
Marine	6%	7%	5%	16%	5%	6%	<b>7%</b>
Energy	5%	2%	2%	4%	2%	3%	<b>4%</b>
Motor	2%	1%	10%	2%	1%	4%	<b>3%</b>
Aviation	2%	2%	2%	4%	2%	4%	<b>2%</b>
<b>Total GWP</b>	<b>50%</b>	<b>6%</b>	<b>15%</b>	<b>14%</b>	<b>10%</b>	<b>5%</b>	<b>100%</b>

#### Significant events during the reporting period

Major claims, those which result in a net loss of £20m or more for the market, were £2,906m in 2018 (2017: £4,539m), net of reinsurance and including reinstatements payable and receivable. Total industry insured losses for the catastrophe events of 2018 are estimated to be US\$85bn (2017: US\$145bn).

After a long period of relatively benign major loss activity pre-2017, the cost of major claims to the Lloyd's market in 2018 is the fourth highest since 2003, in today's terms. This continued period of high losses follows on from 2017, which was the third highest year for losses over that period.

The largest insured natural catastrophe event was Hurricane Michael. This event, which devastated large parts of Florida, was the second of two large hurricanes to hit the US in the second half of 2018. The other large hurricane being Hurricane Florence, which caused significant wind and flood damage in North and South Carolina.

The market once again incurred significant claims from wildfires in California in November. Other notable events included a volcanic eruption in Hawaii in May, Typhoons Jebi and Mangkhut striking Asia in August and September, and losses resulting from a fire at the Lürssen shipyard in Germany in September.

The Lloyd's market has been more than able to meet these substantial commitments without any impact on our total resources which remain strong. Lloyd's financial ratings remain at A (Excellent) from A.M. Best, A+ (Strong) from Standard & Poor's and AA- (Very Strong) from Fitch.

Lloyd's Brussels (Lloyd's Insurance Company S.A), Lloyd's first Europe-wide operation, was established during 2018 and commenced underwriting on 1 January 2019. It has been set up to ensure Lloyd's partners across Continental Europe can continue to access the market's underwriting expertise and financial security after the UK has left the EU.

Lloyd's Brussels is authorised and regulated by the National Bank of Belgium and capitalised according to Solvency II rules. It is licenced to write all non-life risks from the European Economic Area and benefits from the market's financial strength through member capital and the Central Fund.

## A.2 Underwriting performance

The Lloyd's result for 2018 is described and analysed in detail in pages 24 to 35 '2018 Highlights' of Lloyd's Annual Report 2018. This provides a qualitative and quantitative description of the result at an aggregate level and by material line of business.

The overall underwriting result is summarised below:

	2018	2017
	£m	£m
Net premiums earned	25,178	24,498
Net claims incurred	(16,438)	(18,250)
Net operating expenses	(9,870)	(9,669)
<b>Total</b>	<b>(1,130)</b>	<b>(3,421)</b>
Combined ratio	104.5%	114.0%

The underwriting result by material line of business is summarised below:

	2018	2017
	£m	£m
Reinsurance	(456)	(1,330)
Property	(700)	(1,757)
Casualty	(183)	(189)
Marine	(343)	(469)
Energy	113	105
Motor	12	(188)
Aviation	(49)	(11)
Life	16	(24)
<b>Sub-total</b>	<b>(1,590)</b>	<b>(3,863)</b>
Transactions between syndicates and the Society	460	442
<b>Total</b>	<b>(1,130)</b>	<b>(3,421)</b>

A summary of business by major geographical location is set out in section A.1 above.

The Lloyd's market reported a pre-tax loss of £1,001m in 2018 (2017: a loss of £2,001m) and a combined ratio of 104.5% (2017: 114.0%), which represents a return on capital of (3.7%) (2017: (7.3%)).

This result is driven by the losses arising from a number of catastrophic events which impacted the insurance industry in the second half of 2018, notably Hurricanes Florence and Michael and the wildfires in California. 2018 was the second successive year of significant catastrophic losses for the insurance industry and so too the Lloyd's market. Insured losses arising from catastrophic events cost the Lloyd's market £2.9bn, net of reinsurance, in 2018 (2017: £4.6bn) and added 11.6% to the combined ratio (2017: 18.5%).

The impact of these major claims on the Lloyd's market result was offset to some extent by prior year releases of £976m (2017: £706m), representing a 3.9% (2017: 2.9%) improvement to the combined ratio.

During 2018 stable or increased pricing levels became more widespread as the year progressed after many years of decline; favourable price movements were seen across all lines of business and more notably in those which had the greatest exposures to the major catastrophic events in 2017. The Lloyd's market experienced a weighted average increase in prices on renewal business slightly over 3% in 2018. In addition, several syndicates exited or severely curbed their risk appetites in poor-performing lines, as Lloyd's began to ramp up its activity to support the market in closing the performance gap.

There has been a small reduction in the operating expense ratio in 2018 reflecting the initial effects of actions being taken by Lloyd's and the market to reduce the cost of doing business; the operating expense ratio is 39.2%, down from 39.5% in 2017. Reducing the Lloyd's market expenses will continue to be an area of focus in 2019.

### A.3 Investment Performance

The investment performance for Lloyd's for 2018 is summarised below:

	2018	2017
	£m	£m
Interest and similar income:		
From financial investments designated as at fair value through profit or loss	836	1,356
From available for sale investments	39	35
From financial instruments designated as held to maturity	-	1
Dividend income	48	37
Interest on cash at bank	50	23
Other interest and similar income	30	35
Investment expenses	(45)	(72)
<b>Total</b>	<b>958</b>	<b>1,415</b>
Other income from investments designated as at fair value through profit or loss:		
Net realised gains/(losses)	(17)	261
Net unrealised gains/(losses)	(464)	89
Other relevant income	27	35
<b>Total</b>	<b>(454)</b>	<b>385</b>
<b>Total investment return</b>	<b>504</b>	<b>1,800</b>

Equity and other risk assets endured a difficult year after a strong investment return in 2017. In 2018, financial markets suffered a volatile risk-off move in the last quarter of the year brought on by trade disputes, fears of a global slowdown, geopolitical risks and less accommodative financial conditions.

Developed market monetary policy continued to be tightened with central banks in the US, Canada and UK raising interest rates. However, core government bonds outperformed over the risk-off move in the fourth quarter. Credit spreads on corporate bond investments widened in line with the general risk-off sentiment.

The market's investments generated a return of £504m (2017: £1,800m), or 0.7% (2017: 2.7%), showing some reduction on the previous year and also well below the five-year average. Syndicate investments returned £333m (0.8%), the notional investment return on members' capital was £178m (0.7%) and the investment return

on Lloyd's central assets was a loss of £7m (-0.2%). In terms of key drivers, an allocation, albeit conservative, to equity and risk assets generated losses for the year but this was more than offset by positive returns in cash, government and investment grade corporate bonds.

Further information on the investment performance is provided on page 28 of Lloyd's Annual Report 2018.

Net losses on investments of £3m (2017: losses £2m) were recognised directly in equity.

Lloyd's has limited exposure to securitised assets and other asset backed securities throughout the Chain of Security. As at 31 December 2018, exposure to these assets totalled £4,125m (2017: £2,978m).

#### **A.4 Performance of other activities**

Other items contributing to the loss of £1,001m (2017: loss of £2,001m) were loss on exchange of £8m (2017: loss £62m) and other income of £33m (2017: £42m), less other expenses of £400m (2017: £360m). Other income related primarily to Society income, largely market charges and charges to members. The other expenses were primarily in respect of Society operating expenses, for which the increase was driven by the costs associated with investment in and set up of Lloyd's Brussels and preparation for the Part VII legacy transfer.

##### Leases

Payments made under operating leases are charged to the Society income statement on a straight-line basis over the period of the lease. Contractual capital expenditure is provided for over the term of the underlying lease agreement. The lease cost provision is an accounting estimate which arises due to the fact the Society has entered into a number of fully repairing leases.

Additional information on lease cost provisions and operating lease commitments for the Society is set out in notes 23 and 26 of the Society accounts at pages 176-177 and 179 of Lloyd's Annual Report 2018 respectively.

#### **A.5 Any other information**

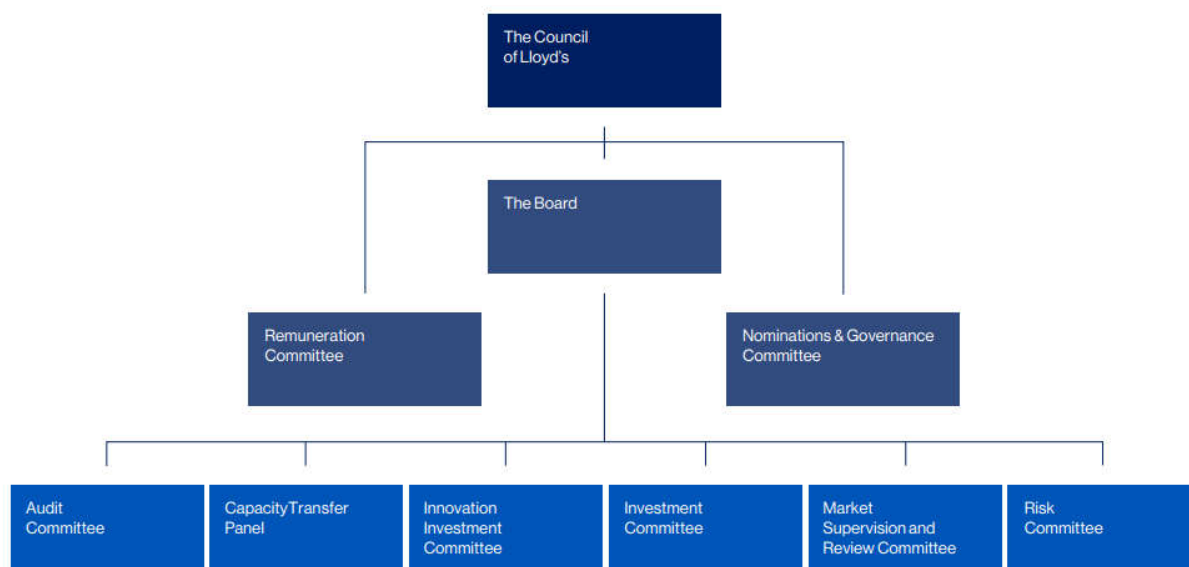
There is no other material information to report.

## B System of Governance

### B.1 General information on the system of governance

#### Structure, roles and responsibilities

The structure of the principal governing bodies of Lloyd's is summarised in the chart below:



#### The Council of Lloyd's

Under Lloyd's Act 1982, the Council of Lloyd's undertakes the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's.

The Council comprises a maximum of 18 members, split between six working, six external and six nominated members. The Chairman and Deputy Chairmen are elected annually by the Council from among its members.

Certain functions are reserved to the Council including:

- The making, amendment or revocation of byelaws
- The setting of Central Fund contribution rates; and
- Appointing the Chairman and Deputy Chairmen of Council.

Beyond the reserved functions, the Council can delegate its powers or functions to any person, committee or employee of the Society.

The Council has delegated authority for the day-to-day management of the market to the Board. The Board is able, in turn, to sub-delegate authority to the Chief Executive Officer (CEO) and through him to the Lloyd's Executive. In addition, the Council has delegated authority to carry out specified functions to committees including the Remuneration, and Nominations & Governance Committees, as summarised below.

#### The Board

The Council established the Board as from 1 January 2003. The Board develops strategies to meet the Corporation Purpose of creating and maintaining a competitive, innovative and secure market.

The Board is responsible for the day-to-day oversight of Lloyd's and thus constitutes Lloyd's Administrative, Management or Supervisory Body (AMSB).

The Board comprises the following members at the date of this report:

- The Chairman of Lloyd's;
- The Lloyd's Chief Executive Officer; the Performance Management Director; and the Chief Financial Officer (the Executive Directors);
- Three non-executives connected with the Lloyd's market; and
- Six independent non-executives.

Specific functions delegated to the Board include:

- Determining the major risks to the Lloyd's market and determining appropriate action to address or mitigate those risks;
- Determining the key factors, levers and drivers which may affect the profitability of the Lloyd's market;
- Developing and implementing a strategy to achieve the Corporation Goal; and
- Supervising, regulating and directing the business of insurance at Lloyd's.

The Board has reserved to itself a list of specific functions and powers that only it may deal with. The Board may sub-delegate authority to the CEO, executive directors and employees of the Corporation save in respect of those functions and powers reserved to it, the Council and their committees.

Matters reserved to the Board include:

- Setting the policy and principles relating to the supervision, regulation and direction of the business of insurance at Lloyd's (the Market Supervision Framework), in compliance with PRA and FCA requirements;
- Considering and approving Lloyd's risk appetite (both at Corporation and market level);
- Setting policy for the admission and removal of participants in the Lloyd's market;
- Admitting and removing managing agents;
- Determining the Franchise Standards for managing agents and approving the Three-Year and Annual Plan and Budget of the Corporation; and
- Approving the Lloyd's Society level capital requirements.

#### The Principal Committees of the Council

##### Nominations & Governance Committee

The Nominations & Governance Committee is responsible for making recommendations to the Council on the appointment of the Chairman, CEO, new nominated Council members, Board members (including the executive directors on the Board), members of a number of the Council and Board committees, and to consult with the CEO on the appointment of members of the Executive who are not members of the Board including the Secretary to the Council. The Nominations & Governance Committee is also responsible for succession planning arrangements for these positions.

The Nominations & Governance Committee shall comprise not more than eight members and is chaired by the Chairman of Lloyd's. Its remaining members are drawn from both the Council and the Board.

The Nominations & Governance Committee reports to the Council and Board on its proceedings after each meeting on all matters relating to its duties and powers. A written report is submitted to the Council annually.

#### Remuneration Committee

The Remuneration Committee is responsible for setting remuneration arrangements for the Chairman, CEO, executive directors and the Secretary to the Council. The Remuneration Committee's proposals are considered by both the Board and the Council.

Non-executive remuneration is decided by the Council, on recommendation from the Chairman and CEO who may consult the Remuneration Committee as part of that process.

The Remuneration Committee is chaired by the Senior Independent Deputy Chairman. The Chairman is a member of the Committee and its remaining members are drawn from both the Council and the Board.

The Remuneration Committee reports to the Council and Board on its proceedings after each meeting on all matters relating to its duties and powers and makes recommendations to the Council or Board on any area within its remit where action or improvement is needed. The Remuneration Committee submits a written report to the Council annually.

#### The Principal Committees of the Board

##### Audit Committee

The Audit Committee's role is to ensure that the financial activities of Lloyd's are subject to independent review and audit.

At the date of this report the Audit Committee comprised two external members of the Council and four non-executive members of the Board.

The Audit Committee's functions include:

- Reviewing Lloyd's annual and interim financial statements, the aggregate syndicate results and the Lloyd's Solvency & Financial Condition Report; and
- Reviewing both the external and internal audit plans.

Reports from the internal and external auditors on aspects of internal control are reviewed by the Audit Committee and appropriate action taken in response.

The Audit Committee submits an annual report to the Board. It also reports to the Council and the Board on its proceedings after each meeting. Additional reports are submitted to the Council and/or the Board on matters of material interest as and when necessary. The minutes of Audit Committee meetings are submitted to the Board and the Council.

##### Risk Committee

The Risk Committee is chaired by an independent non-executive member of the Board, and its other members are drawn from both the Council and the Board. Other individuals including the CEO, Chief Risk Officer, Chief Financial Officer and Performance Management Director are regular attendees with others invited to attend all or part of any meeting as and when deemed appropriate by the Risk Committee or its Chair. The Committee submits an annual report to the Board. It also

reports to the Council and the Board on its proceedings after each meeting. The minutes of Risk Committee meetings are submitted to the Board and the Council.

#### Market Supervision and Review Committee

Market Supervision and Review Committee (MSARC) takes decisions regarding the exercise of Lloyd's enforcement powers. It also acts as a review body capable, where appropriate, of amending, modifying or withdrawing certain decisions taken by the Executive affecting managing agents. It also acts as the body that determines whether certain decisions can be referred to the Lloyd's Appeal Tribunal and can also make certain business decisions.

MSARC meets at the discretion of its Chairman. MSARC submits a written report to the Board annually and may submit additional reports to inform the Board of any matters of material concern as and when required.

#### Capacity Transfer Panel

The Capacity Transfer Panel (CTP) was established principally to exercise the Council's powers in relation to minority buyouts and mergers. The Panel meets at the discretion of its Chairman. The Panel submits a written report to the Board annually and may submit additional reports on matters of material concern as and when necessary.

#### Investment Committee

The Investment Committee monitors the investment objectives and parameters of centrally managed assets and is responsible for reviewing the performance of these funds. In addition, it monitors the investment operations of Lloyd's Treasury and Investment Management department in respect of all funds under its management and approves all investment counterparties. It may also make more general recommendations concerning investment activity at Lloyd's.

The Investment Committee meets at the discretion of its Chairman. The Investment Committee submits a written report to the Board annually and may submit additional reports on matters of material concern as and when necessary. The Investment Committee is required to obtain the approval of the Board before making any decisions which may materially affect the financial risks applying to the Society or Lloyd's market entities.

#### Material changes in the system of governance that have taken place over the reporting period

##### Risk Committee

With effect from 15 October 2018 David Sansom has been acting as Interim Chief Risk Officer.

##### Innovation Investment Committee

This new Committee which held its first meeting in June 2018 is responsible for the development and implementation of investment strategies identified by the Lloyd's Lab. In doing so, the Committee aims to promote an innovative culture within the market and increase the rate of adoption of new technologies and initiatives.

The Committee comprises a maximum of eight members, including:

- Not less than one independent non-executive director of the Board;
- The Chief Financial Officer;
- the Chief Commercial Officer;



- the Chief Operating Officer; and
- at least one member of the Council.

The Committee reports to the Board after each meeting of the Committee.

#### Executive Risk Committee

This Committee was established in March 2018 and comprises members of the Executive Committee

Further information on Lloyd's system of governance may be found on pages 73 to 90 of Lloyd's Annual Report 2018.

#### Information on the remuneration policy

##### Principles of the remuneration policy

Lloyd's operates a Total Reward approach to remuneration, which is designed to meet employee and Corporation needs by providing rewards that are linked to individual performance and the delivery of Lloyd's Corporation objectives.

Lloyd's Total Reward approach is supported by the following practices:

- The approach looks beyond base salary to the value of the total reward package in meeting the needs of employees;
- Lloyd's recognises and rewards superior performance; and
- Lloyd's remuneration practices are designed to promote and reward sound and effective risk management.

The Corporation operates a balanced approach to performance measurement. The annual bonus is linked to Lloyd's key strategic objectives and KPIs are set each year which support the delivery of Lloyd's long-term vision. Lloyd's Market Performance Bonus (previously referred to as Lloyd's Performance Plan, or LPP) is directly linked to the profitability of the Lloyd's market to encourage an attitude of commercial partnership with the market and align the interests of participants with capital providers.

#### The Corporation's executive remuneration policy

The structure of total compensation for the CEO and executive directors is designed to support the strategic priorities and reflect the market oversight role of the Corporation. Prior to the appointment of the new CEO, the Remuneration Committee reviewed the overall shape of remuneration packages for executive directors to ensure that the policy remains relevant for the Corporation going forward. A key conclusion of the review was that the balance of fixed and variable pay should be adjusted for those executives with Board member roles with a reduction in fixed pay, and an increase in variable performance-related pay. The increase in variable pay will be accompanied by a rigorous framework against which performance is assessed. Variable pay will continue to be set below market levels, reflecting the oversight role of the Corporation.

Lloyd's reward policy is designed to facilitate the future success of the Corporation by ensuring that the executive package may be sufficient to attract executive directors of the calibre required to deliver the Corporation's strategic priorities. It seeks to ensure that no more than is necessary is paid on recruitment, while taking into account a highly competitive and global market for talent.

All of Lloyd's executive remuneration practices are designed to protect the brand and reputation of Lloyd's and to promote sound and effective risk management. Incentives (annual performance bonus and market award) are subject to a potential downward adjustment if risk management practices and standards are not considered to have been sufficiently met.

To ensure the long-term sustainability of the Lloyd's brand and reputation, the Corporation operates malus and clawback provisions on all incentives to ensure that senior executives act responsibly and in the long-term interests of the Corporation.

#### Summary of executive remuneration policy for 2019

Salary - Salaries are set to appropriately recognise responsibilities and be broadly market competitive. For 2019, salaries are set as follows: CEO: £650,000; Chief Financial Officer (appointed 1 April 2019): £450,000; and Performance Management Director: £510,000.

Lloyd's Incentive Plan comprises of individual performance and market elements.

Lloyd's Individual Performance Bonus - The discretionary annual bonus links reward to specific and measurable targets aligned with Lloyd's strategy. For 2019, annual bonus maximums (as a % of salary) for the CEO, Chief Financial Officer and Performance Management Director are 100%. Annual bonus awards are subject to a 'risk underpin'. The Remuneration Committee will assess performance against risk and compliance metrics and may apply a downward adjustment where appropriate. For awards in respect of 2016 onwards, a portion of the annual bonus may be deferred for three years, so that total incentives meet the PRA guidance to defer at least 40% of total variable pay.

Lloyd's market performance bonus - this offers an incentive which is directly linked to the profitability of the Lloyd's market. In order to provide a more balanced approach to performance measurement and better reflect the focus of the Corporation and its drive for improved efficiencies and transformation in the Lloyd's market, Profit Before Tax (PBT) and Combined Operating Ratio (COR) will be the key metrics to measure market performance from 2019. For the CEO and executive directors, a maximum cap of 50% of salary applies and awards are subject to a 'risk underpin'. The Remuneration Committee will assess performance against risk and compliance metrics and may apply a downward adjustment where appropriate.

From 2019 the deferral of both the individual performance bonus and the market performance bonus will be simplified and structured as 40% deferral of the combined total award.

Pension - The CEO, CFO and Performance Management Director are members of the Group Personal Pension (GPP) Plan (or equivalent), which is a defined contribution plan. All executive directors receive a cash allowance of 15% of base salary (20% of base for the prior Chief Financial Officer, departing in April 2019).

#### Variable components of remuneration for all Corporation employees

From 2018 Lloyd's variable component of remuneration consists of the following elements within one bonus framework:

- individual performance bonus
- market performance bonus

The annual bonus is subject to a 'risk underpin'. The Remuneration Committee will assess performance against risk and compliance metrics and may apply a downwards adjustment where appropriate.

#### Individual performance bonus

The annual bonus is a discretionary annual bonus plan which links reward to specific and measurable targets aligned with Lloyd's strategy. All Corporation employees are eligible for a discretionary annual bonus, based on performance against objectives and individual key performance indicators for the year.

Any employee who performs below role expectations will not receive an individual performance bonus.

#### Market performance bonus

The market element bonus is available to all employees and has been designed to meet strategic objectives by enabling the Corporation to offer an incentive which is directly linked to the profitability of the Lloyd's market and will therefore encourage an attitude of commercial partnership with the market and align the interests of participants with capital providers; and will provide a competitive reward and therefore assist Lloyd's in attracting and retaining the talented individuals required to develop and support future strategy.

Awards are calculated by reference to profit on ordinary activities before tax (PBT), as reported in the pro forma financial statements in the Lloyd's Annual Report for each financial year, subject to a minimum threshold level. From 2019 the key metrics to measure market performance will be PBT and Combined Operating Ratio (COR).

Deferred pay components are included within the remuneration provision under the market performance bonus as an additional incentive to encourage employee recruitment and retention.

No market performance bonus will be paid to individuals rated as 'inconsistent performers' or those who are performing below role expectations.

#### Remuneration for the Chairman and members of the Council of Lloyd's and Board who are not employees of the Corporation

The current Lloyd's Chairman was appointed effective 15 June 2017 and his fee was £600,000pa. This remains unchanged for 2019. Fees for 2017 for Council and Board members were £38,500 and £62,000 per annum respectively. Fees are unchanged for Board members for 2019. Fees are also payable in respect of membership of a number of Council and Board committees, including ad hoc committees established to consider specific issues requiring a significant time commitment. Fees payable for members of the Risk Committee were increased for 2018. The additional fee payable to the Deputy Chairmen, over and above the standard Council member's fee, was increased to £12,000 per annum for 2018.

Further information on Lloyd's remuneration policy is set out in pages 92 to 104 of Lloyd's Annual Report 2018.

#### Material transactions during the reporting period with persons who exercise a significant influence on the undertaking, and with members of the administrative, management or supervisory body

There were no relevant material transactions during the reporting period.

## B.2 Fit and proper requirements

### Requirements for skills, knowledge and expertise

Lloyd's Fit and Proper Policy sets out how Lloyd's establishes, implements and maintains documented policies and procedures to ensure that the persons who effectively run the Corporation or are responsible for other key functions, behave with integrity, honesty and skill.

The purpose of the policy is to ensure that the relevant persons at all times:

- have the personal characteristics (including being of good repute and integrity);
- possess the level of competence, knowledge and experience;
- have the qualifications;
- have undergone or are undergoing all training required to enable them to perform their functions effectively and in accordance with any relevant regulatory requirements and to enable the sound and prudent management of Lloyd's; and
- discharge their functions in accordance with the relevant FCA and PRA Conduct standards.

The Policy applies to:

- Members of the Council and Board who hold specific Senior Insurance Manager Functions (SIMF) and are required to be pre-approved (including Chairman, Chair of Remuneration Committee, Chair of Audit Committee, CEO, Chief Financial Officer, Chief Risk Officer and General Counsel, and Director, Performance Management);
- All other members of the Council and Board who have to be notified to the PRA and FCA as notified non-executive directors;
- Corporation employees who hold SIMF or controlled functions and are required to be approved by the PRA and FCA or notified to the PRA and FCA (other members of the Executive Committee, and Head of Lloyd's Treasury & Investment ('Key Function Holders'));
- Corporation employees who are "Key Function Performers" (primarily the Senior Leadership Team – typically departmental heads who report directly to members of the Executive Committee).

In relation to the Council and Board, the Nominations & Governance Committee is responsible for recommending appointments to the Board and for nominated members of the Council.

Given that 12 of the 18 members of Council are required by Lloyd's Act 1982 to be elected by members of the Society it is not possible or appropriate for the Nominations & Governance Committee to have specific obligations in respect of the balance of expertise and experience represented on Council. However, for the Board, the Committee does regularly review the structure, size and composition (including skills, knowledge & experience) of the Board and make recommendations to the Council about any changes. Before making any recommendation regarding candidates for appointment to the Board and for nominated members to the Council the Nominations & Governance Committee uses its best endeavours to evaluate the balance of skills, knowledge, experience and diversity on the Council or Board as appropriate and, in light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

In relation to Corporation employees, candidates are recruited through Lloyd's recruitment process which comprises competency-based interviews to enable Lloyd's to assess whether a candidate has the appropriate skills, knowledge and experience for the particular role in question.

#### Process for assessing fitness and propriety

The process for assessing the fitness and propriety of the persons who effectively run the Corporation or have other key functions is described in the Fit and Proper Policy which sets out how Lloyd's performs the necessary fitness and propriety checks prior to appointment and periodically thereafter for the various categories of roles to which the policy applies.

In summary, the Chairman annually reviews the performance of the non-executive members of the Council and the Board and the Senior Independent Deputy Chairman reviews the performance of the Chairman. The Remuneration Committee reviews the performance of the Chairman, CEO and the Executive Committee. The Chief Financial Officer is responsible for reviewing the performance of the Lloyd's Chief Actuary through Lloyd's Performance Appraisal Process. The Audit Committee is responsible for annually reviewing the performance of the Head of Internal Audit and the results of this review are shared by the Chair of the Audit Committee with the CEO who jointly agree remuneration. Other employees who are either key function holders or performers are assessed through Lloyd's performance appraisal process. These reviews take into account the FCA/PRA requirements for fitness and propriety and conduct.

### **B.3 Risk management system including the own risk and solvency assessment**

#### Risk management system

The Lloyd's Risk Management Policy describes its overall framework and approach for the management of risk, including the risk strategy, the internal governance arrangements, tools, processes and reporting procedures.

The Lloyd's Risk Management Framework ('the framework') ensures that the identification, assessment, monitoring and management of all material risks affecting the Society takes place on an ongoing basis. The framework includes a number of risk assessment techniques, which are tailored to specific risk areas.

#### Lloyd's Risk Management Framework

Lloyd's adopts a consistent approach in managing its risks through a process known as the risk and control assessment process, which is conducted on a bi-annual basis. This process re-assesses the existing risks and identifies any new risks. It evaluates the performance of key controls and also seeks to monitor the action plans in place to help manage risks.

The framework also enables Lloyd's to undertake a more forward-looking assessment of risk, building capital consideration into decision making processes. An Own Risk and Solvency Assessment (ORSA) is performed at least annually, bringing together key risk, capital and solvency management information on a more formal basis for the Board on a current and future basis.

#### Implementation of risk management system

The management of all risks is, first and foremost, the responsibility of each employee and department at Lloyd's and decisions taken across the business have the potential to impact the risk profile of Lloyd's to a greater or lesser degree.

The Risk Management Function is responsible for providing a secondary check and balance to ensure the range of risks taken by Lloyd's are well understood, effectively managed and in line with Lloyd's overall strategy and risk appetite. This objective is achieved through operation of the risk management framework.

The Risk Management Function is composed of the risk governance structure and the Risk Management Department. The risk governance structure comprises the Executive Risk Committee and the Risk Committee. These provide clear independent challenge to the risk takers at Lloyd's. The risk committees oversee, challenge and where appropriate escalate issues using appropriate management information sourced from the Risk Management and internal control frameworks, such as the various risk and control assessments, details of the operating and regulatory environment and capital management reports.

A key objective of the Lloyd's risk governance structure is to provide assurance to the Board that risks facing the Society are identified and managed in accordance with approved policy and risk appetite. The Risk Appetite Framework articulates the level of risk believed to be acceptable and desirable for Lloyd's through a series of risk appetite statements and metrics. These are monitored on an ongoing basis by both the business areas responsible for each risk area and the risk committees.

#### ORSA process

The ORSA process is a key element of the risk management framework of Lloyd's. It incorporates a series of processes which ensure an appropriate level and quality of capital is maintained to support the risks taken within Lloyd's on a current and future basis in light of the Lloyd's strategy set by the Board. The key focus of the ORSA is to continually assess Lloyd's own view of the risks faced and associated economic capital needs to meet its strategic goals.

The ORSA draws on existing ongoing oversight activities used to manage market and Corporation risk (including the risk and control assessment process, business plan and capital approval), the member capital setting processes and the determination of a central capital layer.

#### ORSA frequency, review and approval

##### 'Business as usual' basis

The ORSA is an ongoing, continuous process which aligns to the Lloyd's business cycle. As such, the activities of the ORSA are performed through the course of the year and at least annually in line with changes to the Lloyd's risk profile and capital setting cycle. The risk profile is assessed on a quarterly and annual basis. The ORSA report is presented to the Board on a quarterly (in summary version) and annual (detailed version) basis.

##### Ad-hoc basis

Following the occurrence of a significant event, the activities within the ORSA may be revisited to ensure that they are still valid and to assess any potential impact on the level of economic capital and the own funds necessary to meet solvency requirements. Certain trigger events may require all activities within the ORSA process to be revisited, however less material events may only trigger the review of some ORSA components.

##### Governance

The Board has overall responsibility for the review and approval of the ORSA process and report.

The Board will make key decisions and review and approve key outputs through the ORSA report but shall sub-delegate the day-to-day oversight and operation of the ORSA process to the relevant committee and function teams as detailed in the Lloyd's ORSA Policy.

Determination of own solvency needs and interaction of capital management activities with the risk management system

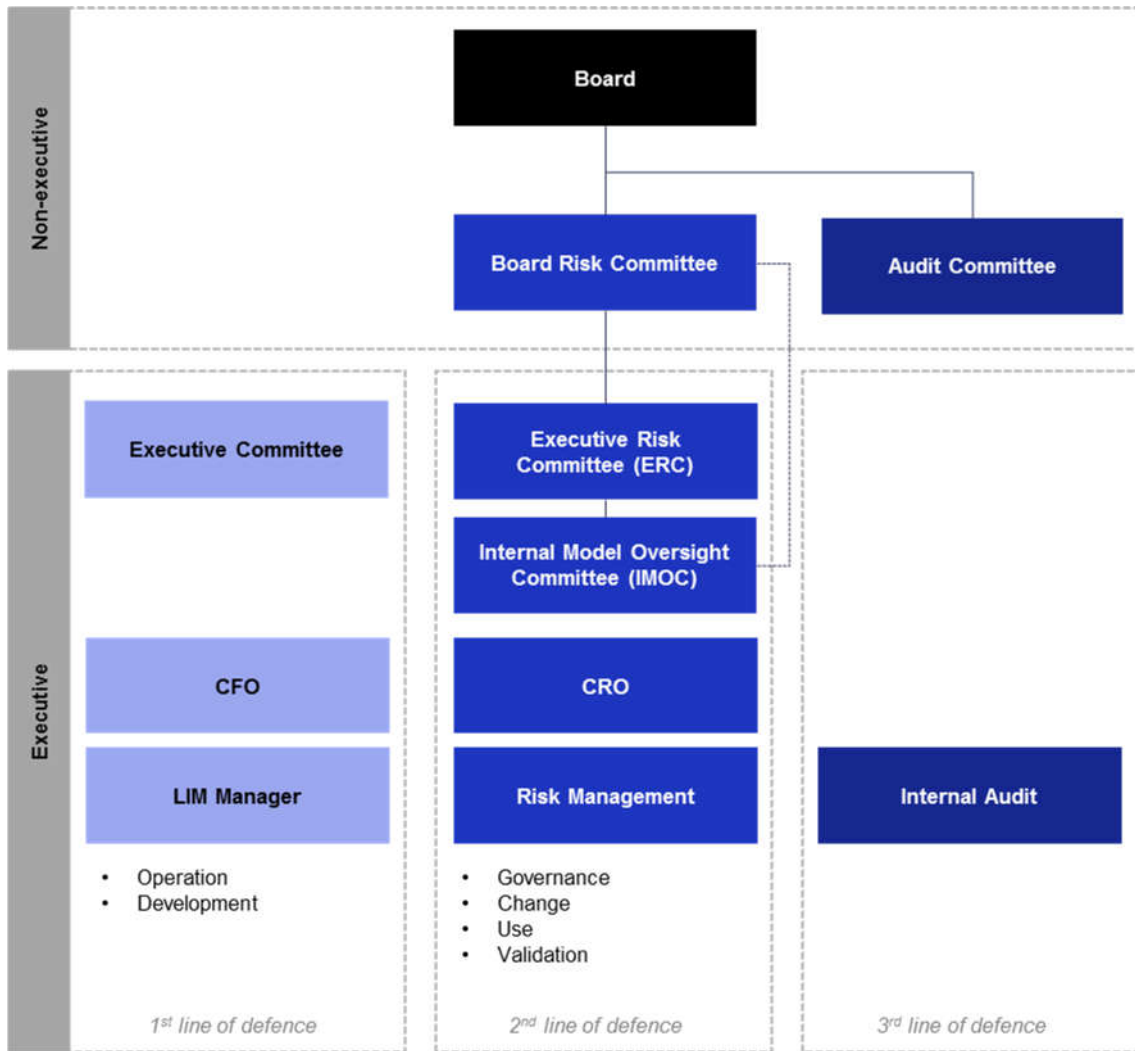
The outcome of the ORSA process is formally documented within the ORSA report. The ORSA report details how Lloyd's has completed its own solvency assessment given its risk profile. Furthermore, it is used to present the results of the various, inter-linked ORSA processes, illustrating the dependencies between strategy, risk, capital and solvency. It provides all the key information which has been assessed and the conclusions reached as part of the ORSA process to provide management with a suitable platform for appropriate oversight and for future strategy setting.

Governance over the Lloyd's Internal Model (LIM)

The LIM is owned by the Board, which relies on the LIM outputs for key decision-making activities. The Board delegates day-to-day duties to the Board Risk Committee to ensure that the design, operation and validation of the LIM are appropriate.

Lloyd's has embedded the structure set out below to ensure effective governance and oversight of the operation, validation and change of the LIM and to ensure that the internal model continues to appropriately reflect the risk profile of the Society.

The Governance framework highlighted below identifies those ultimately responsible for ensuring effective governance of the LIM and satisfying themselves that the operation, change and validation activities are performed in alignment with their respective policies as well as the components involved in the business as usual (BAU) operation and use activities of the LIM, change management processes and the regular cycle of internal model validation.



### Internal model validation

Validation is a key regulatory requirement and seeks to ensure that the LIM is both fit for purpose and that its outputs can be relied upon to make key strategic decisions across the Society. A successful validation is one of the key requirements for maintaining internal model approval.

The validation activity, owned by Risk Management, covers all the risk categories and associated processes of the LIM, both on a quantitative and qualitative basis:

- Quantitative validation:
  - Attritional claims;
  - Catastrophe risk (as modelled in the Lloyd's Catastrophe Model, LCM);
  - Reinsurance credit risk;
  - Operational risk (Society and Syndicate);
  - Additional Central Fund (ACF); and
  - Market risk (with investment risk modelled in the Lloyd's Investment Risk Model, LIRM)
- Qualitative validation:
  - Model use;
  - Governance of the model;
  - Documentation; and
  - Systems & IT for the LIM



The validation process is performed over a three-year cycle. The purpose of the three-year cycle is to:

- Ensure validation activity is spread throughout the year;
- Allow a risk-based validation approach with majority of activity focused on the material risk areas;
- Ensure validation activity is directed at the areas which have been subject to change, e.g. methodology changes to ensure continuous model development or parameter updates to reflect changes to risk profile; and
- Allow targeted, in-depth validation activity into thematic areas.

The three-year validation cycle is implemented through four categories of tests:

1. **Core tests:** these are validation tests which are run annually, regardless of any risk profile or model changes. The suite of core tests covers all areas of the model but will be focused on the material areas;
2. **Extended tests:** these are considered as extensions of the core tests, which are only necessary to run once within a validation cycle, assuming it has not been subject to either model or risk profile changes;
3. **Additional tests:** additional testing carried out in response to breaches of certain triggers; and
4. **Deep dives:** targeted, in-depth validation reviews.

Validation at Lloyd's is a continuous and iterative process. A validation plan detailing the timings of the process will be considered and agreed prior to each three-year validation cycle and reviewed and updated annually. Any validation actions agreed throughout the cycle are fed back into the design, operation and development of the internal model and reflected in the validation plan.

Lloyd's approach to the LIM validation ensures independence throughout the validation process. This is designed to ensure that the Validation is separated from ownership of and interest in the LIM or its constituent components. This is demonstrated through clear allocation of roles and responsibilities to the Primary Validators (e.g. component owners) and the Independent Validator.

The Independent Validator is responsible for defining the scope and coverage of the validation with the Primary Validator responsible for specifying the validation tests to be performed and for conducting these tests. The Primary Validator is responsible for interpreting the test results and scoring them. This requires the Primary Validator to have the appropriate level of expertise to interpret the results and provide robust challenge.

The above process is supported by clear and transparent recording of results and the escalation of issues to the Independent Validator, Internal Model Oversight Committee, Board Risk Committee and the Board, if required.

In addition, if no suitable internal resource can be found to validate certain aspects of the model component(s) / LIM, external resources can be brought in to support the process.

## **B.4 Internal control system**

### Internal control system

An effective system of internal control is a critical component of a successful business: it provides the foundation for the safe and sound operation of a business,

ensuring compliance with relevant laws and regulations and the safeguarding of assets.

Internal control at Lloyd's comprises a set of continually operating processes involving the Board, as Lloyd's AMSB, senior management and all levels of personnel who by acting together ensure that the specific goals and objectives of Lloyd's are met and that a strong control culture is prevalent across the business.

An effective internal control system is key to embedding responsibility for risk management across the business and supporting the attainment of overall business strategy. The internal control system is designed to reduce, rather than eliminate, and identify ways to mitigate the risk of failure to achieve business objectives and can only provide reasonable but not absolute assurance against material misstatement or loss.

The Board, on behalf of the Council of Lloyd's, has responsibility for the Society's system of internal control and for reviewing its effectiveness. The Audit Committee monitors and reviews the effectiveness of the system of internal control, providing biannual reports to the Board. The Executive Committee is responsible for the implementation and maintenance of the internal control system and for instilling a strong internal control environment across the Corporation and market.

Lloyd's internal control system provides the foundation for the safe and sound operation of the business, ensuring compliance with relevant laws and regulations and the safeguarding of assets.

The Internal Control Policy describes the way in which the key components of the Lloyd's internal control system act together to ensure assurance processes are operationalised and risk oversight is applied. This policy describes key processes such that Lloyd's can consistently demonstrate:

- Effectiveness and efficiency of operations;
- Compliance with applicable laws, regulations and administrative provisions; and
- Availability and reliability of financial and non-financial information.

#### Implementation of the compliance function

The compliance function, part of the Risk & Regulatory function, focuses on:

- Maintaining Lloyd's relationship with the PRA and FCA
- Reviewing regulatory requirements for impact on the Corporation and liaising with management on changes to processes; and
- Periodically checking that management processes are compliant with PRA / FCA rules (this includes audits conducted by Internal Audit).

The Compliance function reports updates on PRA / FCA issues to the Executive Risk Committee and the Board Risk Committee.

## **B.5 Internal audit function**

#### Implementation of the internal audit function

The Purpose, Authority and Responsibility of the Internal Audit function is defined within the Internal Audit Charter and Operating Standards. Internal Audit's mission is to provide reliable independent and objective assurance to the Audit Committee and

Executive Committee on the adequacy, effectiveness and sustainability of the system of internal control.

The primary scope of Internal Audit's activities is the examination and evaluation of the adequacy and effectiveness of the systems of risk management, internal control and governance processes for the Corporation of Lloyd's and its subsidiaries. In addition to this, Internal Audit's scope will include review of:

- compliance with policies, procedures, laws and regulations;
- reliability and integrity of information;
- means of safeguarding, verifying and accounting for assets;
- economic and efficient use of resources; and
- the accomplishment of strategic objectives.

To ensure adequate audit coverage of the Company's systems and controls an "audit universe" and risk based annual plan is prepared by Internal Audit. The audit universe and annual Plan are developed independently by Internal Audit with full reference to:

- the Executive Committee's and senior management views of the key risks facing the business;
- expectations and issues raised by the regulator;
- the Risk Management team, to ensure all relevant risks are addressed in a plan that forms part of a value adding assurance framework; and
- Internal Audit's discussions with the external auditor.

The Plan is submitted to the Executive Committee for their review prior to approval by the Audit Committee.

#### Independence of the internal audit function

The Internal Audit Charter and Operating Standards establish the framework in which the internal audit function operates. This includes affirming the independence of the internal audit function, stating that internal audit must be independent from management at all times to be effective in executing its work freely and objectively, including:

- The Head of Internal Audit has a direct reporting line, with direct and unlimited access, to the Chair of the Audit Committee and a secondary reporting line to the Chief Executive Officer;
- The Audit Committee is responsible for the approval of Internal Audit's annual Plan and the overall budget;
- Internal Audit is authorised to review all areas of Lloyd's and has full, free, and unrestricted access to all activities, records, property, and personnel necessary to complete their work including correspondence with regulators and Board and Committees meeting minutes;
- Internal Audit is authorised to allocate resources, set frequencies, select areas, determine audit scopes and apply audit tools and techniques, and to obtain the necessary assistance and specialised services within or outside Lloyd's to accomplish its objectives;
- Internal Audit reports with significant findings will be reported in full to the Audit Committee;
- Internal Audit has the right to be informed by management, on a timely basis, of any significant control failures identified by management or the external auditor; and

- The Head of Internal Audit has the right to attend and observe all or part of Executive Committee meetings and any other key management decision making forums where they would have the appropriate standing, access and authority to challenge the Executive.

Internal Auditors have no direct responsibility or authority over any operating activities reviewed and should not relieve others of their responsibilities. Internal Audit are specifically prohibited from performing management activities, including:

- performing operational duties, including operation of policies and procedures;
- initiating or approving accounting transactions; and
- undertaking consulting engagements, specifically, those engagements where the primary aim includes process improvement, implementation of systems, or advising on operating practices (e.g. benchmarking).

Furthermore, Deloitte LLP provides co-sourced internal audit resource who report directly to the Head of Internal Audit. The Audit Committee keeps under review the relationship with Deloitte LLP and the procedures to ensure appropriate independence of the internal audit function is maintained.

## **B.6 Actuarial function**

The Actuarial Function is a mandatory key function introduced by the Solvency II legislation. The Lloyd's Actuarial Function (LAF) carries out a number of activities during each year, both qualitative and quantitative. Lloyd's unique structure means that any requirements in respect of the Actuarial Function apply at both syndicate level and at the overall Society level. Syndicates are therefore required to have their own Actuarial Functions (SAFs) and part of the role of the LAF is to ensure these individual SAFs maintain the required standards.

The accountabilities and governance of the LAF are outlined in its Terms of Reference. The LAF and SAFs have a defined set of tasks which must be performed to adhere to the regulations as set out in the Solvency II Directive. These are to:

- Coordinate the calculation of technical provisions including:
  - Ensuring the use of appropriate methods and assumptions;
  - Ensuring sufficiency and quality of data; and
  - Comparing best estimates against experience;
- Express an opinion on the overall underwriting policy;
- Express an opinion the adequacy of reinsurance arrangements; and
- Contribute to the effective implementation of the risk management system with particular regard to risk modelling and ORSA.

The LAF meets the requirements by:

- Providing an appropriate framework (e.g. issuing guidance, standards and requirements) for syndicates to operate and monitoring compliance against this framework; and
- Complying centrally through its own activities used to monitor the market.

The work of the LAF is continuous over the course of the year. The requirements relating to technical provisions encompass the calculation exercise of these undertaken by the LAF and oversight of SAF calculations. Measures of SAF oversight include review of the SAF reports together with other quantitative and qualitative information submitted to Lloyd's. Together these exercises are designed

to highlight any potential issues with the level of technical provisions for the market and take appropriate action to remedy these.

The requirement to provide opinions on reinsurance and underwriting is satisfied at individual syndicate and Society level. At the Society level this involves collaborations with other areas of the Corporation with primary oversight responsibility for underwriting and reinsurance.

Contribution to the risk management process and the ORSA is achieved through the LAF work with respect to the Lloyd's Internal Model. Evidence of similar contribution is also required from SAFs.

The LAF provides a written report to the Board, on an annual basis, documenting all the tasks that it has undertaken, results, identifying any deficiencies and giving recommendations as to how such deficiencies should be remedied. The LAF also receives reports from all SAFs on an annual basis, covering the areas outlined above.

## **B.7 Outsourcing**

### Description of outsourcing policy

Lloyd's has established an Outsourcing Policy to provide a clear overview of the processes, controls and reporting procedures in place to ensure that the outsourcing of its functions or activities does not adversely affect Lloyd's or the Market's risk profile, or Lloyd's ability to meet regulatory responsibilities. The Outsourcing Policy has been prepared in accordance with Solvency II requirements, in particular Articles 41 and 49 of the Solvency II Directive and Article 274 of the Solvency II Final Delegated Acts published in January 2015. The Policy also seeks to adhere to guidance within the FCA Handbook on Outsourcing (SYSC 13.9).

Lloyd's performs many activities necessary for the operation of its business, including providing services required in support of the efficient running of the Lloyd's Market. In some instances, it may be considered more cost effective to utilise the services of an external supplier with the necessary expertise. In these circumstances, Lloyd's may enter into an outsourcing arrangement with a third-party supplier.

Outsourcing arrangements result in a shift from direct to indirect operational control of the activity and have the potential to increase the exposure of Lloyd's to operational risk. The Board, as Lloyd's AMSB, remains fully responsible for any activity or function outsourced and must ensure that Lloyd's does not outsource any activity which will unduly raise its exposure to operational risk.

Strong governance and management oversight over the outsourcing process, combined with assurance provided by regular management information, are essential controls for managing outsourcing risk and understanding the impact of outsourcing on Lloyd's business.

### Outsourcing of critical or important operational functions or activities

Lloyd's is currently utilising several suppliers to undertake critical activities on its behalf. Details of the activities they provide and the jurisdictions they operate in are shown in the table below:

<b>Services Provided</b>	<b>Jurisdiction</b>
Market critical regular and bespoke data and reporting	United Kingdom
Managed Services – IT Application & Facilities Management	United Kingdom
Settlements & Trust Fund operations	United Kingdom
Software provider of systems to exchange business information with syndicates	China
Support & Development of Lloyd's website	United Kingdom
Professional Services – Legal & Tax Services	United Kingdom
Insurance Transaction Services	Canada
Internal Audit (co-sourced)	Global
Actuarial Services	Hong Kong
Lloyd's Internal Model Validation	United Kingdom
Provider of Risk & Direct Report solutions to the Market	United Kingdom
Provider of regulatory reporting systems for US & Canada	United Kingdom
Provider of Settlements software	United Kingdom
Provider of fund management systems	United Kingdom
Providers of company ownership to dormant corporate members	United Kingdom
Provider of Auction software	United Kingdom
Provider of coverholder business system	Japan

## **B.8 Any other information**

### Assessment of adequacy of the system of governance

In accordance with the UK Corporate Governance Code, an external and independent evaluation of the performance of the Council, the Board, Audit, Remuneration and Nominations Committees is undertaken every three years. The last external evaluation took place in September 2018.

The Secretary to the Council conducted an assessment of the Council, the Board, Audit, Remuneration and Nominations Committees during 2018. The assessment was based on the results of questionnaires issued to the members of these bodies. The principal conclusion of the assessment was that the current governance arrangements were working effectively and in accordance with the Governance Policies and that the Council and its principal committees were operating in accordance with their terms of reference.

The recommendations for improvement will be taken forward under the guidance of the Chairman and the Secretary to the Council.

### Any other material information

There is no other material information to report.

## C Risk profile

### Overview

At Lloyd's, the risk profile originates from both syndicates and at central level.

Syndicates are the source of the majority of risks. They source all the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the day-to-day operational activity. The syndicate risks include: insurance risk (underwriting, reserving and catastrophe risk); market risk on central assets; market risk on syndicate assets (including credit risk on Premiums Trust Funds (PTF)); reinsurance and other credit risk; and syndicate operational risk.

At the central level, additional risks arise from central operational risk, market risk on central assets and pension fund risk.

### Solvency Capital Requirement (Solvency II basis)

The Solvency Capital Requirement (SCR) represents the amount of capital required to withstand a 1 in 200-year loss event over a 12-month time horizon. Given Lloyd's unique structure there are two SCRs which are monitored under the Solvency II regime:

- The Lloyd's market wide SCR (MWSCR) is calculated to cover all the risks of 'the association of underwriters known as Lloyd's', i.e. those arising on syndicate activity, members' capital provided at Lloyd's and the Society taken together, at a 99.5% confidence level over a one-year time horizon as provided for in Solvency II legislation. All the capital of the component parts of the market taken together is available to meet the MWSCR.
- The Lloyd's central SCR (CSCR) is calculated in respect of only the risks facing the Society and the Central Fund at the same confidence level and time horizon used to calculate the MWSCR. The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with Lloyd's rigorous capital setting rules.

Individual syndicates are also required to calculate a SCR, at a 99.5% confidence level over a one-year horizon, for each underwriting year; this drives the determination of member level SCRs. Each member's SCR is derived as the sum of the member's share of the syndicate's one-year SCR. Where a member participates on more than one syndicate, a credit for diversification is provided to reflect the spread of risk. The MWSCR and CSCR are derived from the Lloyd's Internal Model which has been approved by the PRA. Individual syndicates also derive SCRs from their own internal models which are subject to approval by the Lloyd's Capital and Planning Group. The appropriateness of each syndicate's internal model, including changes thereto and the reasonableness of the key assumptions are assessed as part of the Corporation's oversight of the Lloyd's market.

### Lloyd's Internal Model

The Lloyd's Internal Model (LIM) is a purpose-built model designed to calculate the MWSCR and CSCR as required under Solvency II. It covers all risk types and all material risks for the aggregation of syndicates as well as for the Corporation, allowing for the unique capital structure of Lloyd's. The LIM consists of three main components: the Lloyd's Investment Risk Model (LIRM) which simulates economic variables and total assets returns; the Lloyd's Catastrophe Model (LCM) which

models catastrophe risk using syndicates' views of risk; and the Capital Calculation Kernel (CCK) which is the main element of the LIM where all other risks are simulated, and all risks are combined.

Syndicates calculate their own SCR, however, the market wide and central capital requirements are derived from Lloyd's parameterisation at a whole market level to build a view of total market capital requirements from the ground up using market level assumptions. The LIM uses a methodology whereby losses from insurance and other risks are simulated by class of business, allocated to syndicates and through to members to assess the level of capital required by the market and centrally to meet 1 in 200-year losses over the one-year time horizon.

#### Lloyd's MWSCR

The MWSCR is broken down into the various risk components at 31 December 2018 as shown below.

	Dec 2018	Dec 2017
	£m	£m
Reserving risk	6,705	6,183
All other (attritional) underwriting risk	5,865	5,733
Catastrophe risk	2,972	3,923
Operational risk	739	728
Reinsurance credit risk	597	523
Market risk	501	181
Pension risk	22	14
<b>MWSCR before adjustments</b>	<b>17,401</b>	<b>17,285</b>
Foreign exchange adjustment to reflect the change of the US dollar against sterling in the second half of the year	349	(335)
<b>MWSCR</b>	<b>17,750</b>	<b>16,950</b>

### **C.1 Insurance Risk (including underwriting risk)**

The dominant category of risk faced by Lloyd's syndicates is insurance risk. This is the risk arising from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. In practice, insurance risk can be subdivided into:

- (i) underwriting risk;
- (ii) reserving risk; and
- (iii) catastrophe risk.

#### Underwriting risk

This includes the risk that a policy will be written for too low a premium, provide inappropriate cover, or that the frequency or severity of insured events will be higher than expected.

Underwriting strategy is agreed by the board of each managing agent and set out in the syndicate business plan that is submitted to the Corporation for approval each year. Approval of business plans – and setting the capital requirements needed to support these plans – is the key control the Corporation uses to manage underwriting risk.

The Corporation reviews each syndicate business plan to ensure it meets Lloyd's standards and is consistent with the capabilities of the managing agent. Once a plan is agreed, the Corporation uses performance management data to identify whether



each syndicate's business performance is progressing in line with the business plan or that variations are understood and accepted.

The managing agents' underwriting controls should ensure that underwriting is aligned with their strategy, agreed business plan and underwriting policy. Managing agents are expected to have controls in place to ensure that regulatory requirements and the scope of Lloyd's market licences are clearly understood and that risks are written within those requirements.

Managing agents need to have clear processes for pricing business and an audit trail to show how pricing will deliver the projected results within the approved business plan and how pricing will be managed over the relevant underwriting cycle.

The Corporation does not seek to eradicate the inherent risks of insurance risk from the market but to ensure that they are managed within a commercial and prudent underwriting environment. The key processes that provide assurance to the Board include:

- Reviewing and agreeing syndicate business plans and capital;
- Quarterly performance monitoring;
- Minimum standards compliance;
- New entrant approval;
- Risk governance; and
- Risk appetite monitoring.

#### Reserving risk

Reserving risk arises where the reserves established in the balance sheet are not adequate to meet eventual claims arising. The level of uncertainty varies significantly from class to class but can arise from inadequate reserves for known or Incurred but Not Reported claims (IBNR claims). These shortfalls can arise from inadequate reserving processes or from the naturally uncertain progress of insurance events. Lloyd's current level of aggregate market reserves remains robust and the continued level of overall reserve releases are supported by underlying claims experience being more favourable than expected.

Syndicates set reserves and obtain an annual Statement of Actuarial Opinion ("SAO"). The SAO is produced under the guidance of the UK Actuarial Profession; the Lloyd's Actuary has close access to the relevant committees in the UK professional body and is able to ensure that the guidance is kept in line with Lloyd's objectives.

Additional reserve monitoring exercises undertaken by Lloyd's include:

- Lloyd's makes projections at market level and in some cases at syndicate level;
- Relative Reserve analysis, comparing reserve strength between syndicates;
- IBNR burn analysis;
- Large loss monitoring; and
- Setting Reserving Minimum Standards.

#### Catastrophe risk

Catastrophe risk is the risk of loss occurring across all lines of business from worldwide natural catastrophe events. Managing agents may use catastrophe modelling software, where appropriate, to monitor aggregate exposure to catastrophe losses. The Corporation has developed a suite of Realistic Disaster Scenarios to measure syndicate level and aggregate market exposure to both natural

catastrophes and man-made losses. These are monitored frequently, and syndicates supply projected probabilistic exceedance forecasts for Lloyd's key exposures with their capital and business plans. Further enhancements to the monitoring and oversight of aggregate market catastrophe risk exposure have been implemented within the approved internal model under Solvency II.

Lloyd's Realistic Disaster Scenarios (RDS) stress test the aggregation of risks at both an individual syndicate level and for the market as a whole. The event scenarios are regularly reviewed to ensure they represent material catastrophe risks.

## **C.2 Market risk**

Market risk is the risk that the values of financial instruments will fluctuate because of movements in foreign currency, interest rates or asset values. Syndicate assets are held in premium trust funds (PTFs) and are subject to the asset rules contained in the PRA's handbook. Market risk can arise in respect of the investments held by syndicates and centrally in respect of capital provided by members and assets held by the Society including the Central Fund.

Market risk represents the risk that movements in financial markets will affect the financial position of the Society. Market risks arising from the disposition of the Society's investments are monitored against defined parameters using Value at Risk (VAR) methodology. The position is reviewed regularly by the Investment Committee. Investments are actively monitored on a fair value basis and all investments are designated as fair value through profit or loss.

Managing agents manage asset risk through their investment strategy. There is greater oversight of market risk in light of the volatile economic climate, which includes the monitoring of Investment Management Minimum Standards. Assets are monitored across the full Lloyd's Chain of Security to ensure the asset disposition of the market and Corporation remains appropriate, closely monitoring global economic and market trends.

The potential financial impact of changes in market value is additionally monitored through the capital setting process, and asset mix must be reported to Lloyd's on a quarterly basis, including credit rating analysis of fixed income portfolios.

Market risk comprises three types of risk:

- (a) currency risk;
- (b) interest rate risk; and
- (c) equity price risk.

### Currency risk

Managing agents must identify the main currencies in which each syndicate transacts its business. For the market overall, the US dollar is the largest currency exposure. Assets are then held in each of those currencies to match the relevant liabilities. Managing agents must ensure that assets match liabilities and take corrective action where a mismatch arises. Lloyd's also reviews the matching of assets to liabilities at the syndicate level as well as at the market level.

### Interest rate risk

Interest rate risk is the risk that the value and future cash flows of a financial instrument will fluctuate because of changes in interest rates. In general, Lloyd's operates a generally conservative investment strategy with material cash and short dated bonds portfolios, which gives rise to low levels of interest rate risk exposure.

### Equity price risk

Equity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk). Those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. Financial assets and liabilities may be exposed to equity price risk. Such risks are managed by setting and monitoring objectives and constraints on investments, diversification plans and limits on investments in each sector and market. In aggregate there is no significant concentration of equity price risk.

## **C.3 Credit risk**

Credit risk represents the risk of financial loss if a counterparty, or the issuer of a security, fails to meet its contractual obligations. The assets of syndicates, members' capital and Society assets are exposed to credit risk.

The market's principal credit risk is that the reinsurance purchased to mitigate gross losses does not respond as expected. This can occur because reinsurers are unable to settle their liabilities. Managing agents are expected to have a clear and comprehensive plan for the reinsurance of each syndicate. This takes into account risk appetite for retained insurance risk and the potential for the accumulation of risk. Managing agents are expected to regularly monitor and assess the security of, and exposure to, each reinsurer, intermediary and any collateral arrangements that support their reinsurance protections. Reinsurance credit risk is subject to quarterly review by Lloyd's.

Society assets are also exposed to credit risk. With regard to credit investments, Lloyd's performs further credit analysis and does not solely rely on external credit ratings as an indicator of investment eligibility. This includes a top-down approach (macroeconomic environment and cyclical outlook) and a bottom-up approach (business fundamentals, issuer analysis and security analysis).

## **C.4 Liquidity risk**

Liquidity risk arises where there are insufficient funds to meet liabilities, particularly claims. This may affect assets held by syndicates, provided as members' capital and held by the Society.

Managing agents are expected to manage the cash needs of their syndicates on an ongoing basis and to avoid becoming forced sellers of assets. They are required to have an asset liability matching (ALM) policy which describes how they manage any duration risk arising from a mismatch between syndicate investments and policyholder liabilities. Generally, syndicates have a high concentration of liquid assets, namely cash and government securities.

The value and term of short-term assets are carefully monitored against those of the Society's liabilities. The Society maintains sufficient liquid assets to meet liabilities as they fall due. The liquidity of the Central Fund is monitored separately.

Lloyd's centrally monitors syndicate liquidity both in terms of asset mix and future funding needs and conducts stress tests to monitor the impact on liquidity of significant claims events.

## C.5 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk is modelled using a scenario analysis approach, generating operational loss scenarios in conjunction with business teams. This may arise at syndicate level and centrally.

Managing agents manage these risks through internal compliance monitoring and the use of detailed procedure manuals. Lloyd's sets minimum standards to be applied by agents and monitors to ensure these are met.

Syndicate SCRs calculated with internal models are also required to include a capital requirement in respect of operational risks. The methodology used will be different for each syndicate (as operations are different) but all syndicates are obliged to include their operational risk exposures within their internal model.

In addition, elements of operational risk which arise as a result of syndicate operations but are not felt to be adequately captured in their internal models are modelled centrally. This is known as Additional Central Fund (ACF) risk.

## C.6 Other material risks

### Regulatory risk

Regulatory risk is the risk of loss owing to a breach of regulatory requirements or failure to respond to regulatory change. Managing agents monitor regulatory development to ensure ongoing compliance and any impact on claims reserves. Additionally, given current developments in the global regulatory landscape, the Corporation closely monitors changes which may adversely impact the global licence network. Lloyd's is actively working with the market to assist and adapt to the changes in the UK regulatory architecture, in particular the increased focus on conduct risk by the FCA; managing agents are now expected to comply with the Lloyd's Conduct Minimum Standards. Similarly, Lloyd's monitors global political trends and is taking action at both a Corporation and market level in response to a growing geopolitical risk facing companies operating around the world.

### Group risk

Group risk is the risk of loss resulting from risk events arising within a related entity. While Lloyd's is not a group, the Corporation monitors potential risks which could impact Lloyd's, for example arising from the activities of a parent company of a syndicate or managing agent. Whilst, by its nature, group risk is difficult to control, the Corporation mitigates the potential impact of group risk through the implementation of controls, including Lloyd's minimum standards, mitigating any material impairment to Lloyd's brand, reputation or strategic priorities.

### Concentration risk

Lloyd's closely monitors concentrations of risk across the market and tests risk exposure against clearly defined risk appetites as established by the Board. Specialist supervisory teams across Lloyd's monitor concentrations across the following areas: region-perils, class of business, geographical location, and method of distribution in insurance and investment counterparties, amongst others. Whilst syndicates define the type of business that they write, at the market level Lloyd's seeks to avoid inappropriate concentration of premium sources, monitoring concentration of business in poorly performing classes, and material sources of premium by method of placement as well as coverholder concentration, which feature in risk appetite metrics reported quarterly to the Board. Managing agents

controlling more than 10% of overall market gross written premium are also subject to Board review. Any reported metrics outside of appetite are reported to and discussed by the Risk Committee and the Board. Specific and targeted actions can then be agreed, which will be discussed with specific managing agents or the market as a whole, as appropriate. These actions can vary considerably depending on the nature of the risk or the class of business impacted, with different levels of the requirements placed on syndicates, which forms part of Lloyd's oversight role of the market.

#### Prudent person principle

In accordance with Article 132 of Directive 2009/138/EC, all assets at Lloyd's are invested in accordance with the prudent person principle.

#### Syndicate level assets

Managing agents, as trustees, are responsible for the investment of their own syndicate PTFs. The members of the syndicate are the primary bearers of financial risk. Managing agents identify planned investment risk within the SCR and members are required to provide sufficient capital to support this risk. PTF investments must be managed in accordance with PRA requirements under the Prudent Person Principle. PTF investments must also comply with the Membership & Underwriting Requirements (M&URs) issued by Lloyd's. Syndicates must submit information on investment returns and dispositions to Lloyd's quarterly.

Syndicate investment data is analysed and assessed by Lloyd's quarterly. Where a concern is identified at syndicate level, Lloyd's may consider the issue in the context of the syndicate's overall operations. Lloyd's may engage with the managing agent to identify whether appropriate risk limits have been exceeded and, if so, may require investment dispositions to be amended, or more typically that additional capital be provided by members, as appropriate.

When reviewing syndicate submissions, Lloyd's will have regard to its defined risk appetites. These specify that overall market risk (across all syndicates) should not exceed 20% of total syndicate risk, reflecting that the Lloyd's market is primarily structured to take on and manage insurance risks, not investment risk. Wherever an individual syndicate plans or adopts more than 20% market risk, this is subject to specific review and approval by Lloyd's.

Lloyd's also considers periodically whether any additional rules should be adopted for prudential reasons beyond the PRA requirements of the Prudent Person Principle.

If Lloyd's identifies that in aggregate, syndicates are exposed to inappropriate levels of investment risk, it may constrain the investment dispositions of all syndicates and amend the M&URs.

#### Member level capital (FAL)

Each member of Lloyd's is responsible for the investment of their own FAL and is the primary bearer of the resulting financial risk. Lloyd's acts as trustee and custodian of FAL assets and reviews all transactions in advance of approving them for settlement. All FAL investments must comply with the PRA requirements under the Prudent Person Principle; additionally, they must also comply with the Lloyd's M&URs. Annually the processes for checking the assets for the solvency calculation are subject to an annual external audit.

FAL investment dispositions are analysed quarterly by Lloyd's. Where concerns are identified, Lloyd's may engage with members to understand risk strategies and may

require that investment dispositions be amended. Where members do not comply with such requirements Lloyd's, in its capacity as trustee, may intervene to amend investment dispositions. Lloyd's may also require a member to maintain additional assets within their FAL if that member's FAL investments exceed defined risk limits. If Lloyd's identifies risks which are unacceptable when considering all FAL assets, or all FAL and PTF assets together, it may, in extremis, adjust permitted investments for all participants by amending the M&URs.

Lloyd's also considers periodically whether any additional rules should be adopted for prudential reasons beyond the PRA requirements of the Prudent Person Principle.

#### Central resources

Lloyd's complies with the Prudent Person Principle in respect of central resources by ensuring that:

- Lloyd's does not invest in investments that are not admitted to trading on a regulated financial market or in complex products which are difficult to value. Neither does it invest in investments which are not traded or traded on a non-regular basis.
- Derivatives are only permitted to facilitate risk management and not speculation. Lloyd's use of derivatives is currently limited to forward foreign exchange contracts and interest rate swaps. Effective risk transfer is obtained by transacting both these derivatives under Master International Swaps and Derivatives Association (ISDA) agreements with the derivative counterparties. Considerations of how the quality, security, liquidity and profitability of the Central Fund portfolio is improved without significant impairment of any of these features is made by the Lloyd's Investment Committee. Approved procedures have been implemented in line with this risk policy to monitor the performance of these derivatives and against defined risk limits.
- Before investing in securitised assets, the Corporation ensures that Lloyd's interests and the interests of the originator or sponsor concerning securitised assets are well understood and aligned. All securitised assets must meet Solvency II eligibility criteria.

#### **Stress testing**

Lloyd's seeks to continuously identify and examine Stress and Scenario Tests (SSTs) which may have an adverse impact on the business model to ensure potential risks are clearly understood, monitored effectively and adequate controls are in place.

The outcomes/conclusions of the SSTs form an integral part of the overall risk management system and act as a prompt to senior management to take action across a range of areas such as: implementing changes to the LIM, re-evaluating risk appetites, reviewing the application of Franchise Guidelines, business plan decisions for syndicates and capital management decisions (e.g. setting Economic Capital). The results of these, as reflected in the ORSA process, inform Lloyd's management in terms of making decisions with regard to member level and central capital strategy over the medium term.

Further information on stress tests, sensitivity analysis and the outcomes of these are provided in respect of the Lloyd's market at pages 56 and 57, and for the Society at pages 160, 170 and 177, of the Lloyd's Annual Report 2018, and also in respect of the Lloyd's market at pages 33 and 34 of the Aggregate Accounts 2018.

## **C.7 Any other information**

As reported on R0790 of template S.23.01 as shown in Appendix 1, the total of Expected Profit In Future Premiums (EPIFP) as at 31 December 2018 amounted to £3,356m (2017: £1,676m).

Additional information on risk management at Lloyd's may be found at note 4 of the market results (pages 46 to 58) and pages 113 and 114 with respect to the Society within the Lloyd's Annual Report 2018 and note 3 'Risk Management' on pages 25 to 35 in the Aggregate Accounts 2018.

## D Valuation for Solvency Purposes

Sections/items indicated with an asterisk (\*) are **unaudited**.

A comparison of Lloyd's UK GAAP and Solvency II balance sheets is summarised in the following table:

31 December 2018	UK GAAP	Change	Solvency II
	£m	£m	£m
<b>Assets</b>			
Deferred tax assets	31	-	31
Intangible assets	6	(6)	-
Investments	60,162	623	60,785
Loans and mortgages	201	37	238
Property, plant & equipment held for own use	12	(12)	-
Reinsurers' share of technical provisions	23,394	(9,398)	13,996
Deferred acquisition costs	4,680	(4,680)	-
Deposits to cedants	35	61	96
Insurance and reinsurance receivables	17,151	(11,926)	5,225
Receivables (trade, not insurance)	1,016	(44)	972
Cash and cash equivalents	10,877	(8,443)	2,434
Any other assets	443	33	476
<b>Total assets</b>	<b>118,008</b>	<b>(33,755)</b>	<b>84,253</b>
<b>Liabilities</b>			
Technical provisions	78,318	(78,318)	-
- Best estimate	-	55,245	55,245
- Risk margin*	-	3,430	3,430
Provisions other than technical provisions	25	8	33
Pension benefit obligations	90	-	90
Deposits from reinsurers	169	219	388
Deferred tax liabilities	-	-	-
Derivatives	34	68	102
Debts owed to credit institutions	223	-	223
Insurance and reinsurance payables	7,877	(5,536)	2,341
Payables (trade, not insurance)	2,080	(383)	1,697
Subordinated liabilities	-	822	822
Any other liabilities	970	(27)	943
<b>Total liabilities</b>	<b>89,786</b>	<b>(24,472)</b>	<b>65,314</b>
<b>Net excess of assets over liabilities</b>	<b>28,222</b>	<b>(9,283)</b>	<b>18,939</b>



31 December 2017	UK GAAP	Change	Solvency II
	£m	£m	£m
<b>Assets</b>			
Deferred tax assets	36	-	36
Investments	55,765	364	56,129
Loans and mortgages	175	9	184
Reinsurers' share of technical provisions	20,183	(8,675)	11,508
Deferred acquisition costs	4,304	(4,304)	-
Deposits to cedants	18	35	53
Insurance and reinsurance receivables	14,803	(10,698)	4,105
Receivables (trade, not insurance)	734	294	1,028
Cash and cash equivalents	12,137	(9,825)	2,312
Any other assets	241	199	440
<b>Total assets</b>	<b>108,396</b>	<b>(32,601)</b>	<b>75,795</b>
<b>Liabilities</b>			
Technical provisions	71,270	(71,270)	-
- Best estimate	-	50,146	50,146
- Risk margin*	-	2,975	2,975
Provisions other than technical provisions	15	10	25
Pension benefit obligations	164	-	164
Deposits from reinsurers	111	(4)	107
Deferred tax liabilities	11	-	11
Derivatives	22	8	30
Debts owed to credit institutions	176	-	176
Insurance and reinsurance payables	6,884	(4,862)	2,022
Payables (trade, not insurance)	1,606	16	1,622
Subordinated liabilities	-	908	908
Any other liabilities	577	(4)	573
<b>Total liabilities</b>	<b>80,836</b>	<b>(22,077)</b>	<b>58,759</b>
<b>Net excess of assets over liabilities</b>	<b>27,560</b>	<b>(10,524)</b>	<b>17,036</b>

A qualitative description of the reasons for differences between UK GAAP and Solvency II is set out at section D.1 (assets), D.2 (technical provisions) and D.3 (liabilities other than technical provisions).

## D.1 Assets

### Valuation of assets including differences between Solvency II and UK GAAP

#### Overview

Lloyd's requires each syndicate to prepare a Solvency II balance sheet in accordance with Solvency II valuation rules.

Members' FAL are valued at fair value and thus comply with Solvency II valuation principles.

Assets and liabilities of the Society of Lloyd's are valued in accordance with IFRS where appropriate for solvency. Adjustments are made as necessary to reflect Solvency II valuation principles.

### Recognition

Assets are recognised only when economic benefits are expected to be received in future.

Under Solvency II, future cash flows relating to insurance and reinsurance contracts are included in the measurement of technical provisions. However, overdue cash flows are treated as insurance receivables in the balance sheet. This is the same principle that Lloyd's has applied in the recognition of insurance receivables. Lloyd's has applied similar principles as those applied for insurance receivables in assessing recognition of reinsurance receivables. Amounts recoverable from reinsurers relating to claims paid have been included in the balance sheet as reinsurance receivables.

### Derecognition

Assets are derecognised once they have been transferred to a third party i.e. substantially all risks and rewards are transferred.

### Valuation methodology

Assets are valued at fair value and Solvency II allows two approaches in determining the value of assets i.e. mark to market, and where this is not feasible, mark to model.

### Deferred tax assets

Deferred tax assets relate solely to the Society of Lloyd's. This is because syndicates account for their results gross of tax. Tax is assessed at member level and is outside of the scope of the Lloyd's financial statements. Deferred tax assets are recognised for all deductible temporary differences and unutilised tax losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences or tax losses can be utilised. Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the reporting date.

### Investments

Most of Lloyd's investments i.e. premium trust funds, FAL and Central Fund assets are fixed income investments. These are mainly government bonds and corporate bonds. In addition, significant amounts of equities are held, particularly within members' FAL and the Central Fund.

Information of the valuation of investments for the purposes of the financial statements may be found on pages 62 and 63 of the Lloyd's Annual Report 2018. There are no material differences in the valuation of investments for Solvency II and UK GAAP. However, the allocation of accrued interest has been included within the relevant investment assets rather than in 'Any other assets'.

### Government bonds

These are valued at market value i.e. based on quoted prices. These bonds are regularly traded and hence their prices are easily obtained. These prices are obtained from the custodians. However, where these are not considered current, a tradable quote from a broker is sought.

### Corporate bonds

Most of the corporate bonds are of very high quality i.e. BBB rating and above. These bonds are regularly traded and hence their prices are easily obtained. Similar to the government bonds, these are valued at market value, based on the quoted prices

provided by the custodians. Similar to government bonds, where prices from custodians are deemed not to be fresh, a tradable quote from a broker is sought.

#### Equity and investment funds

Equity investments held by Lloyd's are mainly listed and hence their prices are readily available. These are valued at market value based on the quoted prices provided by custodians.

#### Loans and mortgages

These consist of the following:

- Loans and mortgages to individuals – relating to recoverable Central Fund loans made to hardship members; and
- Other loans and mortgages – relating to syndicate investment assets classified as loans and mortgages other than 'Loans and mortgages to individuals' and 'Loans on policies'.

These are initially recognised in the financial statements at amortised cost. There are no material differences in the valuation of the 'loans and mortgages' held by Lloyd's for Solvency II compared with UK GAAP.

#### Deposits to cedants

These are deposits relating to reinsurance accepted business. Solvency II requires that all assets should be measured at fair value. However, book value as per UK GAAP may be used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

#### Insurance and reinsurance receivables

Solvency II requires that all assets should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk-free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

While determining the valuation amount, Lloyd's has considered the recoverability of these balances; hence the amount recognised in the balance sheet is net of expected losses as a result of default.

There are no material differences in the valuation of 'insurance and reinsurance receivables' for Solvency II and UK GAAP. However, under Solvency II, future cash flows relating to insurance and reinsurance contracts are included in the measurement of technical provisions, excluding overdue cash flows which remain as insurance receivables in the balance sheet.

#### Receivables (trade, not insurance)

Solvency II requires that all assets should be measured at fair value. However, receivables may be recognised at their book value using UK GAAP where these assets crystallise within one year; in this case no discounting is applied as this would be immaterial.

#### Cash and cash equivalents

'Cash and cash equivalents' comprise of cash in hand and demand deposits, together with short term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of change in

value. These are short term investments with a maturity period of three months or less from the date of acquisition.

Cash in hand and demand deposits are valued at the amount held at the end of the year plus accrued interest at the end of the year, where applicable.

The value of letters of credit, guarantees and life policies provided within FAL, which represent ancillary own funds (see section E.1 below), and which are included in 'cash and cash equivalents' in the table in section D are excluded from the Solvency II balance sheet but are recognised at their Solvency II valuation as ancillary own funds in the own funds template.

#### Any other assets

These include items such as prepayments and accrued income. Solvency II requires that all assets should be measured at fair value. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

## **D.2 Technical provisions**

### Solvency II technical provisions by material line of business

The tables below summarise the Solvency II technical provisions for the market by high-level class of business:

31 December 2018

Class	Gross best estimate	Net best estimate	Risk margin*	Total net technical provisions including risk margin
	£bn	£bn	£bn	£bn
Accident & Health	1.65	1.44	0.08	1.52
Aviation	1.63	1.16	0.06	1.23
Casualty Financial & Professional Lines	10.05	7.33	0.39	7.72
Casualty Other	11.48	8.88	0.50	9.37
Casualty Treaty	3.67	3.28	0.13	3.42
Energy	3.98	2.70	0.29	2.99
Marine	6.42	5.13	0.40	5.53
Property (Direct & Facultative)	7.36	5.33	0.31	5.64
Property Treaty	6.37	3.93	1.14	5.06
Specialty Other	2.65	2.06	0.14	2.20
<b>Total</b>	<b>55.24</b>	<b>41.25</b>	<b>3.43</b>	<b>44.68</b>

31 December 2017

Class	Gross best estimate	Net best estimate	Risk margin*	Total net technical provisions including risk margin
	£bn	£bn	£bn	£bn
Accident & Health	1.55	1.44	0.08	1.52
Aviation	1.94	1.40	0.08	1.48
Casualty Financial & Professional Lines	8.70	6.72	0.34	7.06
Casualty Other	10.11	8.00	0.46	8.46
Casualty Treaty	3.28	2.99	0.16	3.15
Energy	3.83	2.72	0.35	3.07
Marine	6.07	4.90	0.40	5.30
Property (Direct & Facultative)	7.85	5.57	0.37	5.94
Property Treaty	4.77	3.21	0.62	3.83
Specialty Other	2.05	1.69	0.12	1.81
<b>Total</b>	<b>50.15</b>	<b>38.64</b>	<b>2.98</b>	<b>41.62</b>

A summary of technical provisions by Solvency II line of business is provided in Appendix 1 on templates S.12.01 and S.17.01.

#### Calculation of technical provisions

The technical provisions are calculated in line with the prescribed Solvency II requirements as per Articles 76 to 86 of Directive 2009/138/EC. In particular, the value of technical provisions correspond to the current amount insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking. The calculation of technical provisions makes use of and is consistent with information provided by the financial markets and generally available data on underwriting risks (market consistency).

The technical provisions are calculated by syndicates in accordance with Lloyd's Technical Provisions Guidance February 2018. The calculations are undertaken by individual syndicates with the calculation basis and assumptions made at this level. Across the market the following bases, methods and assumptions are most relevant:

- Provisions for future claims are the most material element of the technical provisions;
- Provisions for future claims are based on standard actuarial techniques for estimation of non-life insurance liabilities;
- Assumptions relating to run-off patterns and loss ratios are material to the calculation of future claims provisions;
- Risk-free rates as provided by EIOPA are used with no adjustment;
- With regard to contract boundaries all contracts to which the syndicate is legally obliged are included and each existing contract, including reinsurance, is considered in its own right; and
- Reinsurance recoveries are calculated based on consideration of the inwards exposures and the reinsurance in place, including the impact of any claims experience to date.

The calculations are undertaken by individual syndicates with the calculation basis and assumptions made at this level. This includes the consideration of homogenous risk groupings used for the valuation, which will vary between syndicates based on the consideration of the specific syndicate risk profile.

#### Level of uncertainty associated with the value of technical provisions\*

Provisions for future claims are the most material and uncertain element of the technical provisions. The associated uncertainty of these provisions is assessed by all syndicates and also by the Corporation, using both quantitative techniques and qualitative commentary on sources of uncertainty. Consideration of the uncertainty is undertaken for each syndicate as part of their reserving processes. This will focus on the areas of particular uncertainty specific to each syndicate and involves statistical reserving techniques, sensitivity and scenario testing and consideration of large reserves associated with individual losses. This information is received and reviewed by Lloyd's as part of SAO and Actuarial Function reporting. Centrally the Lloyd's Actuarial Function assesses the uncertainty in aggregate market provisions via the same methodologies. Further assessment of quantitative uncertainty in the technical provisions is made as part of internal modelling at syndicate and Corporation level.

In addition to the quantification provided in the LIM, Lloyd's also monitors sources of uncertainty using the Statement of Actuarial Opinion (SAO) process. Each syndicate is required to provide an opinion, given by an actuary with an appropriate Practising Certificate, on reserve sufficiency. As part of this opinion any key sources of uncertainty are required to be highlighted and quantified. For the 2018 year end the number of wordings has reduced significantly when compared to 2017 but still remains elevated relative to 2013-2016. The large loss wordings are a combination of 2017 Hurricanes and various major events in 2018. The uncertainty associated with these provisions is considered as part of syndicate capitalisation.

#### Valuation differences of technical provisions by material line of business between Solvency II and UK GAAP

The technical provisions on a Solvency II basis are calculated in line with Solvency II requirements. There are a number of significant differences between this calculation basis and the UK GAAP basis underlying the financial statements.

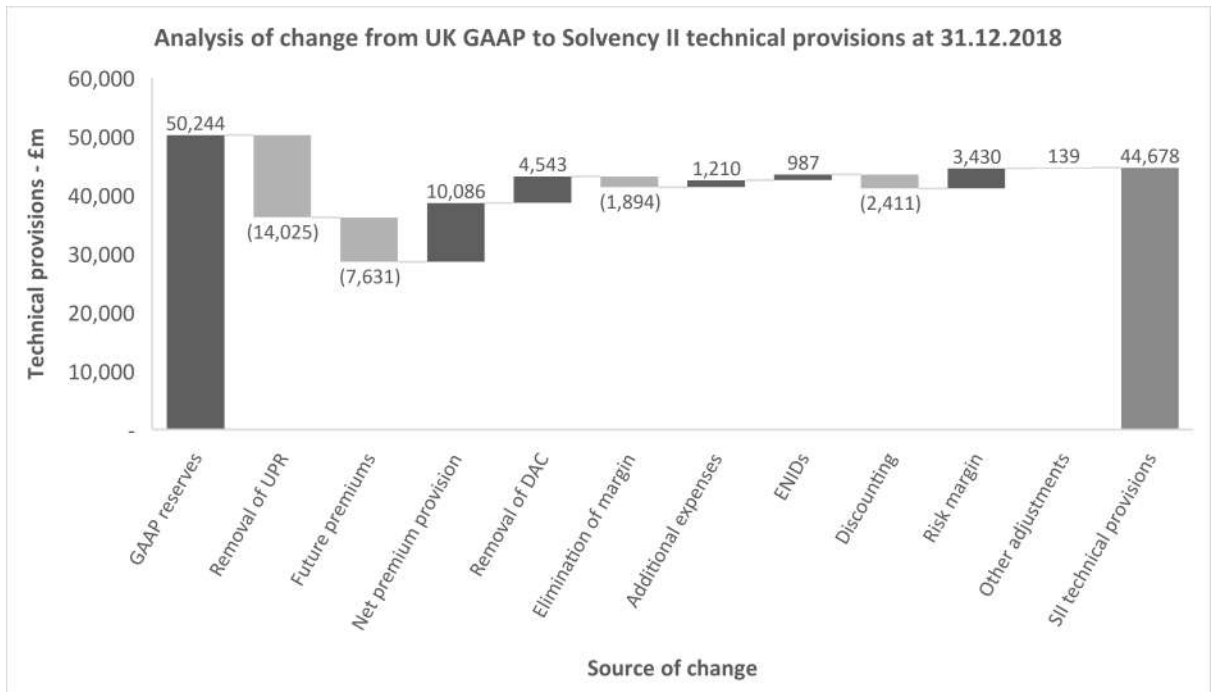
The material differences in the bases are summarised below:

- Removal of the requirements to hold an unearned premium reserve (UPR) and to allow for other non-monetary items;
- Movement to a cashflow basis for valuation of both gross business and outwards reinsurance. This means that future premium income is introduced into the technical provisions;
- The claims associated with the unearned business must also now be included, in place of the UPR provision;
- Removal of any implicit or explicit margins within technical provisions to give a "true best estimate" for solvency purposes, defined as the mean of the full range of all possible future outcomes;
- Inclusion of all expenses incurred in running-off the existing business, rather than only those relating to cost of claims administration;
- Introduction of the valuation of very low probability extreme events including latent claims, referred to as "Events not in Data" (ENIDs);
- Introduction of discounting of all reserves at risk-free rates, rather than discounting being related to expected investment income and only being allowable on particular claim types; and

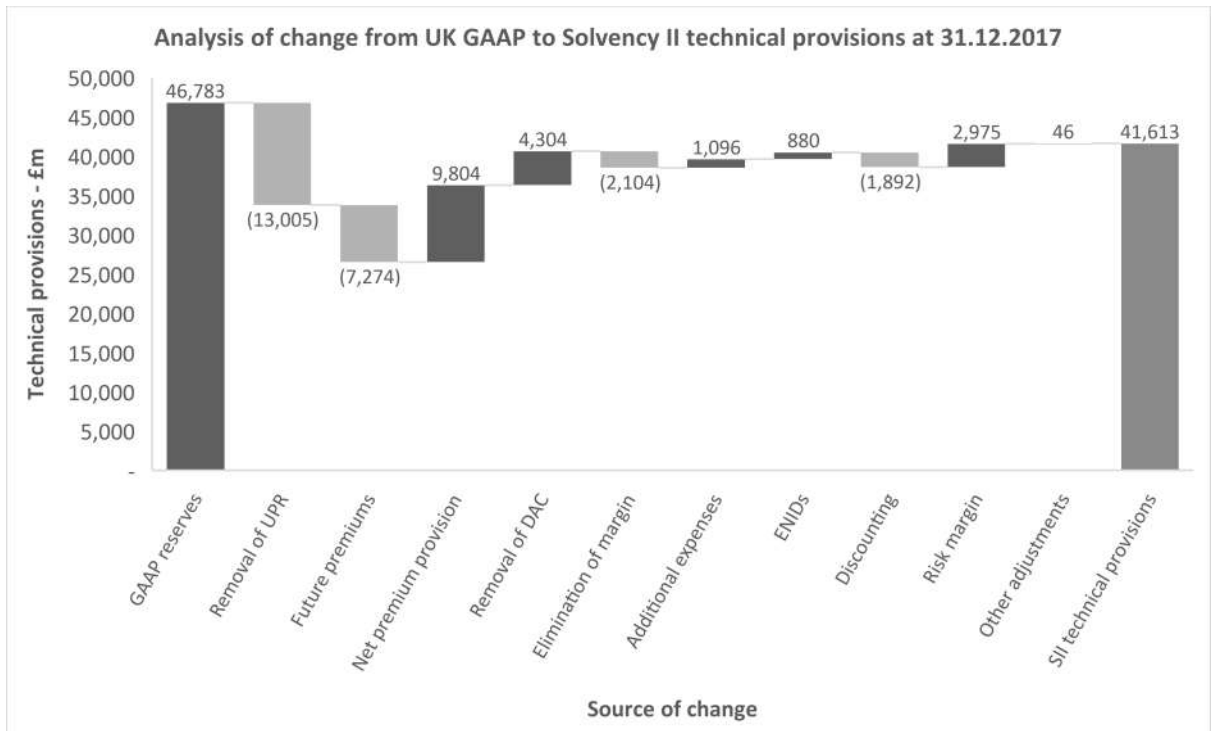
- Inclusion of a risk margin sufficient to cover the expected cost of transfer of the obligations.

The impacts of the above changes are summarised in the charts below:

31 December 2018



31 December 2017



For Lloyd's the most material impact relates to the inclusion of future premium, though this is offset to an extent by future claims.

The UK GAAP and Solvency II net technical provisions by material line of business are summarised below:

31 December 2018

Class	UK GAAP net technical provisions	Solvency II net technical provisions including risk margin*
	£bn	£bn
Accident & Health	1.89	1.52
Aviation	1.54	1.23
Casualty Financial & Professional Lines	8.52	7.72
Casualty Other	10.21	9.37
Casualty Treaty	3.72	3.42
Energy	3.20	2.99
Marine	6.46	5.53
Property (Direct & Facultative)	6.12	5.64
Property Treaty	5.15	5.06
Specialty Other	3.42	2.20
<b>Total</b>	<b>50.24</b>	<b>44.68</b>

31 December 2017

Class	UK GAAP net technical provisions	Solvency II net technical provisions including risk margin*
	£bn	£bn
Accident & Health	1.79	1.52
Aviation	1.77	1.48
Casualty Financial & Professional Lines	7.85	7.06
Casualty Other	9.14	8.46
Casualty Treaty	3.30	3.15
Energy	3.21	3.07
Marine	6.17	5.30
Property (Direct & Facultative)	6.11	5.94
Property Treaty	4.55	3.83
Specialty Other	2.89	1.81
<b>Total</b>	<b>46.78</b>	<b>41.62</b>

Matching adjustment (per Article 77b of Directive 2009/138/EC)

Lloyd's does not permit the use of the matching adjustment by syndicates in the setting of technical provisions.



Volatility adjustment (per Article 77d of Directive 2009/138/EC)

Lloyd's does not permit the use of the volatility adjustment by syndicates in the setting of technical provisions.

Transitional risk-free interest rate-term structure (per Article 308c of Directive 2009/138/EC)

Lloyd's does not permit the use of the transitional risk-free interest rate-term structure by syndicates in the setting of technical provisions.

Transitional deduction (per Article 308d of Directive 2009/138/EC)

Lloyd's does not permit the use of the transitional deduction by syndicates in the setting of technical provisions.

Recoverables from reinsurance contracts and special purpose vehicles

The technical provisions are calculated gross, with reinsurance calculated separately under the same Solvency II principles. All existing and planned future reinsurance purchasing related to the gross provisions is included in the technical provision calculation and associated recoveries resulting from consideration of the expected value of all possible future outcomes is considered. As part of consideration of reinsurance recoveries an allowance for non-payment is also required.

Any material changes in assumptions for calculating technical provisions

Solvency II technical provisions have been reported to Lloyd's since 2012 and there are no material changes to the assumptions compared to those calculated at the previous year-end. However, this is the first year where Lloyd's has asked that the release of earned margin be tested on a reporting year basis and that claims in respect of the unearned premium be at least that estimated by the SAO signing actuary by reporting year, in some cases any load due to these amounts have been included in Other Adjustments in the chart above.

### **D.3 Other liabilities**

Valuation of other liabilities including differences between Solvency II and UK GAAP

A quantitative summary by major class is provided at the start of section D above.

Provisions other than technical provisions

These are liabilities of uncertain timing or amount (excluding liabilities reported under 'Pension benefit obligations').

There are no material differences in the valuation of 'provisions other than technical provisions' for Solvency II and UK GAAP.

Pension benefit obligations

Lloyd's operates a number of defined benefit and defined contribution pension schemes. The principal scheme is the Lloyd's Pension Scheme which is a defined benefit scheme. Other schemes have been established for certain employees based overseas. These have been valued in accordance with IAS19 Employee Benefits.

Additional information in respect of pension scheme obligations may be found in note 13 'Pension schemes' in the Society accounts, on pages 157 to 163 of Lloyd's Annual Report 2018.

Deposits from reinsurers

These are syndicate related amounts received from reinsurers or deducted by the reinsurer according to the reinsurance contract.

Solvency II requires that all assets should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk-free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

#### Deferred tax liabilities

Deferred tax liabilities relate solely to the Society of Lloyd's. This is because syndicates account for their results gross of tax. Tax is assessed at member level and is outside of the scope of the Lloyd's financial statements. Deferred tax is measured on an undiscounted basis at the rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantially enacted at the reporting date.

#### Derivatives

Derivatives have been valued at fair value for Solvency II purposes.

#### Debts owed to credit institutions

These are syndicate related debts such as mortgages, loans, and bank overdrafts owed to credit institutions (excluding bonds held by credit institutions).

Solvency II requires that all assets should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk-free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

#### Insurance & reinsurance payables

Solvency II requires that all liabilities should be measured at fair value. Hence, these are valued at fair value by discounting expected cash flows using a risk-free rate. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are payable within one year or amounts payable in more than one year are not material.

#### Payables (trade, not insurance)

Solvency II requires that all assets should be measured at fair value. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

#### Subordinated liabilities

As at 31 December 2018, Lloyd's had two subordinated debt issues in place. Please refer to section E.1 for more details.

In the financial statements, using UK GAAP, the subordinated debt is initially recognised at fair value, being the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, the subordinated debt is subsequently recorded at amortised cost using the effective interest rate over the period to the earliest option date. Amortised cost is calculated after taking into account issue costs and issue discount.

However, the subordinated liabilities have been revalued at fair value for Solvency II purposes.

In the UK GAAP column of the table shown in section D above, the amount of the subordinated debt liability has been derecognised in accordance with the approach taken in Lloyd's Pro Forma Financial Statements on page 40 of the Lloyd's Annual Report 2018. The subordinated debt liability is recognised at fair value in the Solvency II column and then derecognised at this valuation on the own funds template.

#### Any other liabilities

Solvency II requires that all assets should be measured at fair value. However, book value as per UK GAAP is used as a proxy for the fair value for Solvency II balance sheet purposes where the impact of discounting is not material because the balances are due within one year or amounts due in more than one year are not material.

#### Leases

Payments made under operating leases are charged to the Society income statement on a straight-line basis over the period of the lease. Contractual capital expenditure is provided for over the term of the underlying lease agreement. The lease cost provision is an accounting estimate which arises due to the fact the Society has entered into a number of fully repairing leases.

Additional information on lease cost provisions and operating lease commitments for the Society is set out in notes 23 and 26 of the Society accounts at pages 176-177 and 179 of Lloyd's Annual Report 2018 respectively.

### **D.4 Alternative methods for valuation**

As described in section D.1 above, Lloyd's uses market value i.e. based on quoted prices from custodians to value investments such as government and corporate bonds. However, where these are not considered current, a tradable quote from a broker is sought.

### **D.5 Any other information**

There is no further material information to disclose.

## E Capital Management

Sections/items indicated with an asterisk (\*) are **unaudited**.

### E.1 Own funds

#### Lloyd's SCR and central SCR\*

The Society and the Lloyd's market are regulated by the PRA in accordance with the requirements of the Solvency II regime, which was implemented on 1 January 2016, as 'the association of underwriters known as Lloyd's'.

Lloyd's must calculate and cover two SCRs, given the unique structure of Lloyd's: the Lloyd's market wide SCR and the central SCR. Under the Solvency II regime, it must then ensure that each SCR is covered by eligible capital.

The Lloyd's market wide SCR ("MWSCR") is calculated to cover all the risks of 'the association of underwriters known as Lloyd's', i.e. those arising on syndicate activity, members' capital provided at Lloyd's and the Society taken together, at a 99.5% confidence level over a one-year time horizon as provided for in Solvency II legislation. All the capital of the component parts of the market taken together are available to meet the MWSCR.

The Lloyd's central SCR ("central SCR") is calculated in respect of only the risks facing the Society and the Central Fund at the same confidence level and time horizon used to calculate the MWSCR. The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with Lloyd's rigorous capital setting rules. In such an event, assets from the Central Fund can, at the discretion of the Council, be made available to ensure that policyholders' claims are met. Only eligible capital held by the Society may be used to cover the central SCR.

The MWSCR and central SCR are both calculated in accordance with the Lloyd's Internal Model (LIM) which was approved by the PRA in December 2015 and has since been modified in accordance with the major model change applications approved by the PRA in December 2017 and in December 2018.

#### Objectives, policies and processes for managing own funds

Lloyd's sets medium and long term financial objectives in accordance with among other things, its business objectives, the underwriting environment, broader economic conditions as well as the UK and global regulatory environment and future developments. As part of this work, Lloyd's sets risk appetites in terms of coverage of market wide and central regulatory solvency and economic capital requirements. The calibration of these is reviewed regularly by senior management. This is articulated through Lloyd's risk management strategy and appetite and, in particular, the Medium-Term Capital Management Plan (MTCMP) and ORSA report. Lloyd's Capital Management Policy has been designed to ensure that these objectives, once set, can be complied with through capital management. The coverage of the regulatory and economic target capital requirements is assessed on at least a quarterly basis.

The MTCMP is prepared to assist Lloyd's management in ensuring that it has sufficient capital centrally and across the Lloyd's market, in terms of both quantity and quality (tiering) to be able to meet its current and projected regulatory and economic capital requirements in the medium term (over a three-year horizon). There

have been no material changes to Lloyd's processes for managing own funds during 2018.

Ensuring minimum Tier 1 levels to cover the Lloyd's SCR

Under Solvency II, the SCR must be covered by at least 50% Tier 1 capital. As agreed with the PRA, this test applies to the Lloyd's SCR, which covers the 1 in 200-year loss to the 'association of underwriters known as Lloyd's' (as calculated using the LIM 'capital burn' test), as well applying a similar test to the central SCR which addresses the central capital requirement of the Society.

Most own funds at Lloyd's are Tier 1 but as described below letters of credit (LOCs), guarantees and life policies provided as members' FAL, and the dated subordinated debt issued in 2014 and 2017, constitute Tier 2 assets. The deferred tax asset is classified as Tier 3.

Lloyd's has implemented a policy whereby each member's capital requirement must be covered by at least 50% Tier 1 capital in order to align members' capital requirements with Solvency II regulations. Lloyd's monitors the composition of its capital in terms of amount and quality on an ongoing basis. If coverage of this test becomes marginal, then Lloyd's has in place procedures to require members which make the greatest use of Tier 2 capital within their FAL to substitute part of this with Tier 1 capital.

The coverage of the SCR by Tier 1 capital (as reported on template S.23.01 in Appendix 1) is summarised below:

	Dec 2018	Dec 2017
	£m	£m
Lloyd's SCR	17,750	16,950
Tier 1 capital	17,730	15,906
Tier 1 capital %	99.9%	94%

The tiering test also applies to the central SCR. Lloyd's applies similar procedures to monitor the quality of central capital in this respect.

There were no material changes in respect to the structure or quantum of Lloyd's available own funds, or of Lloyd's processes and procedures in this respect, during 2018.

Own funds classified by tier

A summary of Lloyd's own funds is set out below. The total own funds available to meet the Lloyd's SCR agrees to template S.23.01 R0500:

31 December 2018	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	(2,750)			(2,750)
Members' funds at Lloyd's (FAL)	18,471	7,656		26,127
Society assets:				
Subordinated debt		822		822
Deferred tax			31	31
Balance of net assets	2,009			2,009
<b>Total own funds available to meet the SCR</b>	<b>17,730</b>	<b>8,478</b>	<b>31</b>	<b>26,239</b>
<b>Lloyd's SCR*</b>				<b>17,750</b>
'Excess' own funds not eligible to meet SCR	-	-	-	-
<b>Total own funds eligible to meet the SCR</b>	<b>17,730</b>	<b>8,478</b>	<b>31</b>	<b>26,239</b>
<b>Lloyd's solvency ratio</b>				<b>148%</b>

31 December 2017	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	(1,106)			(1,106)
Members' funds at Lloyd's (FAL)	15,125	9,452		24,577
Society assets:				
Subordinated debt		908		908
Deferred tax			25	25
Balance of net assets	1,887			1,887
<b>Total own funds available to meet the SCR</b>	<b>15,906</b>	<b>10,360</b>	<b>25</b>	<b>26,291</b>
<b>Lloyd's SCR*</b>				<b>16,950</b>
'Excess' own funds not eligible to meet SCR	-	1,885	25	1,910
<b>Total own funds eligible to meet the SCR</b>	<b>15,906</b>	<b>8,475</b>	<b>-</b>	<b>24,381</b>
<b>Lloyd's solvency ratio</b>				<b>144%</b>

Total **available** own funds as at 31 December 2018 compared with 31 December 2017 are summarised below:

	Tier 1	Tier 2	Tier	Total
	£m	£m	£m	£m
31 December 2018	17,730	8,478	31	26,239
31 December 2017	15,906	10,360	25	26,291

The change in available own funds from 31 December 2017 to 31 December 2018 is not significant. Notwithstanding the severe losses incurred across the Lloyd's market in the second half of 2018 significant amounts of new capital were provided at Q4 2018 to recapitalise for the 2019 underwriting year.

#### Syndicate assets

Syndicate assets are the aggregated own funds of all syndicates, net of anticipated profit releases and ring-fenced funds. All syndicate assets are held in the form of on balance sheet items and meet the criteria of Tier 1 basic own funds.

### Members' FAL

FAL provided in the form of cash and investments constitute on balance sheet items and meet the criteria of Tier 1 basic own funds.

A significant proportion of FAL is provided in ancillary own funds, in particular 'letters of credit and guarantees which are held in trust for the benefit of insurance creditors by an independent trustee and provided by credit institutions authorised in accordance with Directive 2006/48/EC' which are classified as Tier 2 ancillary own funds in accordance with Article 96 (2) of the Solvency II Directive.

Whilst letters of credit are considered Tier 2 own funds for solvency purposes and are subject to restriction on coverage of the solvency capital requirement, when called upon they are fully converted into cash which is Tier 1 own funds. In addition, prior to Lloyd's accepting a letter of credit into FAL, a robust assessment of the creditworthiness of the respective financial institution is performed, considering both qualitative and quantitative factors.

As described below, these ancillary own funds are subject to prior approval by the PRA and are reported as Tier 2 ancillary own funds in accordance with the valuation rules provided by the PRA's approval.

### Society assets

As at 31 December 2018 Lloyd's had two subordinated debt issues in place:

- The Sterling 2014 Notes issued in October 2014 – classified as Tier 2 basic own funds under Solvency II.
- The Sterling 2017 Notes issued in February 2017 – also classified as Tier 2 basic own funds under Solvency II.

All other Society assets are classified as Tier 1 basic own funds, with the exception of deferred tax assets which are Tier 3 basic own funds.

### Reconciliation reserve

The amount of the reconciliation reserve reported at R0760 of template S.23.01 (Appendix 1) is £(5,794)m (2017: £(3,296)m). This is comprised of:

	Dec 2018		Dec 2017	
	£m	£m	£m	£m
Syndicate balances per PFFS <sup>1</sup> before deducting:	(1,472)		-	
- Solvency II valuation adjustments	(413)		(128)	
- Members' funds in syndicate (within R0730)	(5,054)		(4,077)	
- Foreseeable distributions (R0720)	(388)		(651)	
- Ring-fenced funds (within R0740)	(477)		(327)	
		(7,803)		(5,183)
FAL per PFFS <sup>1</sup> before deducting	26,483		24,579	
- Ancillary own funds at UK GAAP valuation	(8,012)		(9,454)	
- Other FAL (within R0730)	(18,471)		(15,125)	
		-		-
Society net resources per PFFS <sup>1</sup> before deducting	3,211		2,981	
- Solvency II valuation adjustments	(36)		(34)	
- Subordinated debt (at fair value)	(822)		(908)	
- Deferred tax asset (within R0730)	(31)		(25)	
- Ring-fenced funds (within R0740)	(314)		(127)	
		2,008		1,887
<b>Total</b>		<b>(5,795)</b>		<b>(3,296)</b>

<sup>1</sup> Pro Forma Financial Statements, page 40 of Lloyd's Annual Report 2018

#### Coverage of the Lloyd's SCR with eligible own funds

In accordance with Solvency II rules, the SCR must be covered with at least 50% Tier 1 own funds. Accordingly, the amount of available Tier 2 and Tier 3 own funds which exceeds 50% of the SCR is not eligible to cover the SCR and cannot be calculated as such in the solvency calculation.

This has the potential to impact the Lloyd's solvency ratio calculation as a large part of Lloyd's capital is provided by ancillary own funds which are treated as Tier 2 capital for Solvency II purposes. However, these are assets callable on demand. When called, the proceeds, namely cash, would qualify as Tier 1 capital. Under these circumstances, any amount of Tier 2 capital represented by these assets ineligible to meet the SCR (since they exceed the 50% tiering limit for Tier 2 and Tier 3 Capital set by Solvency II) would then become fully eligible. As at 31 December 2018 the amount of ineligible Tier 2 and Tier 3 capital was £nil (2017: £1,910m, of which £1,885m was LOCs callable on demand).



### Own funds available to meet the Central SCR

31 December 2018	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Society assets:				
Subordinated debt		822		822
Deferred tax			31	31
Balance of net assets	2,009			2,009
Callable layer	784			784
<b>Total central own funds available to meet the SCR</b>	<b>2,793</b>	<b>822</b>	<b>31</b>	<b>3,646</b>
<b>Central SCR*</b>				<b>1,400</b>
'Excess' central own funds not eligible to meet central SCR		122	31	153
<b>Total central own funds eligible to meet the SCR</b>	<b>2,793</b>	<b>700</b>	<b>-</b>	<b>3,493</b>
<b>Central solvency ratio</b>				<b>249%</b>

31 December 2017	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Society assets:				
Subordinated debt		908		908
Deferred tax			25	25
Balance of net assets	1,887			1,887
Callable layer	758			758
<b>Total central own funds available to meet the SCR</b>	<b>2,645</b>	<b>908</b>	<b>25</b>	<b>3,578</b>
<b>Central SCR*</b>				<b>1,600</b>
'Excess' central own funds not eligible to meet central SCR	-	108	25	133
<b>Total central own funds eligible to meet the SCR</b>	<b>2,645</b>	<b>800</b>	<b>-</b>	<b>3,445</b>
<b>Central solvency ratio</b>				<b>215%</b>

#### Callable layer

The Society has the right to make a call on members of up to 3% of members' premium limits ("callable contributions"). The callable contributions can be drawn from members' premiums trust funds without the members' consent. This would result in the transfer of Tier 1 capital from syndicate funds to central resources. The value assigned to the callable layer has been reduced to reflect that part of the callable layer which would not be available in a stressed situation at the central SCR level of confidence.

#### Coverage of the central SCR with eligible central own funds

The capital tiering rules also apply to the coverage of the central SCR. The inclusion of the Tier 2 subordinated debt increases Lloyd's Tier 2 and 3 central capital to £853m. Only £700m – 50% of £1,400m - of this is eligible in the solvency calculation.

Eligible amount of basic own funds to cover Minimum Capital Requirement, classified by tiers

The table below sets out Lloyd's eligible basic own funds to meet the MCR. The total agrees to template S.23.01 R0550:

31 December 2018	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	(2,750)			(2,750)
Members' funds at Lloyd's	18,471			18,471
Society assets:				
Subordinated debt		822		822
Balance of net assets excluding deferred tax	2,009			2,009
<b>Total basic own funds eligible to meet the MCR</b>	<b>17,730</b>	<b>822</b>		<b>18,552</b>

31 December 2017	Tier 1	Tier 2	Tier 3	Total
	£m	£m	£m	£m
Syndicate assets	(1,106)			(1,106)
Members' funds at Lloyd's	15,125			15,125
Society assets:				
Subordinated debt		908		908
Balance of net assets excluding deferred tax	1,887			1,887
<b>Total basic own funds eligible to meet the MCR</b>	<b>15,906</b>	<b>908</b>		<b>16,814</b>

Differences between equity as shown in the financial statements and the excess of assets over liabilities for solvency purposes

31 December 2018	Synds	FAL	Soc <sup>1</sup>	Total
	£m	£m	£m	£m
Capital, reserves and subordinated debt Per PFFS balance sheet (UK GAAP basis) <sup>2</sup>	(1,472)	26,483	3,211	28,222
<u>Solvency II adjustments:</u>				
Syndicate valuation adjustments	(413)			(413)
FAL valuation adjustments re ancillary own funds		(8,012)		(8,012)
Society assets not recognised for Solvency II purposes			(36)	(36)
Recognition of subordinated debt liability at fair value (subsequently derecognised on S.23.02 own funds template)			(822)	(822)
<b>Solvency II excess of assets over liabilities (S.02.01.02 R1000)</b>	<b>(1,885)</b>	<b>18,471</b>	<b>2,353</b>	<b>18,939</b>

31 December 2017	Synds	FAL	Soc <sup>1</sup>	Total
	£m	£m	£m	£m
Capital, reserves and subordinated debt Per PFFS balance sheet (UK GAAP basis) <sup>2</sup>	-	24,579	2,981	27,560
<u>Solvency II adjustments:</u>				
Syndicate valuation adjustments	(128)			(128)
FAL valuation adjustments re ancillary own funds		(9,454)		(9,454)
Society assets not recognised for Solvency II purposes			(34)	(34)
Recognition of subordinated debt liability at fair value (subsequently derecognised on S.23.02 own funds template)			(908)	(908)
<b>Solvency II excess of assets over liabilities (S.02.01.02 R1000)</b>	<b>(128)</b>	<b>15,125</b>	<b>2,039</b>	<b>17,036</b>

<sup>1</sup> Society: Corporation and Central Fund (including subordinated debt)

<sup>2</sup> Lloyd's Pro Forma Financial Statements, page 40 of Lloyd's Annual Report 2018

#### Syndicate valuation adjustments

A key difference from the valuation basis for the financial statements (i.e. UK GAAP basis) compared to Solvency II is the valuation of technical provisions. This involves moving from the 'prudent undiscounted best estimate' basis of valuation used in UK GAAP to a market consistent basis of valuation based on a probability weighted best estimate (therefore stripping out surplus reserves held in syndicate accounts) less discounting for the time value of money, with a risk margin applied on top. In addition, there are differences arising due to the recognition of contract boundaries and reinsurance costs.

Other valuation differences may arise in respect of investments (measured at fair value rather than amortised cost) and recognising the fair value of debtors and creditors due after one year (by discounting them where material for the time value of money).

In addition, the managing agent profit commission must be recalculated as if it was charged on the Solvency II result.

As at 31 December 2018 the net valuation differences in this respect amounted to a negative adjustment of £(413)m (2017: £(128)m).

#### FAL valuation adjustments regarding ancillary own funds (AOF)

FAL treated as ancillary own funds does not appear on the Solvency II balance sheet but instead the eligible amount in line with the valuation rules applied by the PRA is reflected in the own funds template S.23.02.

Accordingly, £8,012m (2017: £9,454m) (in accordance with their UK GAAP valuations) has been derecognised on the Solvency II balance sheet:

AOF item	Dec 2018	Dec 2017
	£m	£m
Letters of credit and guarantees in accordance with Article 96 (2) of Directive 2009/138/EC	7,987	9,427
Life policies	25	27
<b>Total</b>	<b>8,012</b>	<b>9,454</b>

#### Society assets not recognised for Solvency II purposes

The reduction to central assets for solvency purposes is summarised below:

Item	Dec 2018	Dec 2017
	£m	£m
Lloyd's investments (Nelson collection) (due to uncertainty over fair value)	15	13
Plant & machinery (as not valued on a 'fair value' basis)	12	18
Intangible assets (not eligible under Solvency II)	6	-
Provision for Centrewrite MCR (as Centrewrite's assets are included in the aggregate Society accounts)	3	3
<b>Total</b>	<b>36</b>	<b>34</b>

#### Subordinated debt

The Lloyd's Pro Forma Financial Statements (see page 40 of Lloyd's 2018 annual report) derecognise the liability in respect of the subordinated debt in arriving at the £3,211m (2017: £2,981m) net resources reported above. This liability is recognised at the fair value of £822m (2017: £908m) in the Solvency II balance sheet before being subsequently derecognised at that value in the own funds template S.23.02.

The subordinated debt is comprised of the Sterling 2014 Notes and Sterling 2017 Notes.

The notes are subordinated obligations of the Society. Each tranche of the notes will rank pari-passu with the other in a winding-up of the Society. Upon the occurrence of any winding-up proceedings of the Society, payments on the notes will be subordinated in right of payment to the prior payment in full of all other liabilities of the Society, except for liabilities which rank equally with or junior to the notes. Payments on the notes will also be subordinated to certain payments which may be made out of central assets including payments made to discharge the liabilities of an insolvent member to any person (including any policyholders) arising out of, or in connection with, insurance business carried on at Lloyd's by that insolvent member and payments made in respect of the costs required by or under any insolvency procedure to which the Society or the Lloyd's market may be subject. However, in the event of a winding-up of the Society, the claims of the holders of the Notes rank senior to the distribution of any central assets to members of Lloyd's generally (other than payments made to members in their capacity as senior creditors of the Society).

The Sterling 2014 Notes issued on 30 October 2014 mature on 30 October 2024 and bear interest at a rate of 4.75% per annum, payable annually in arrears on 30 October in each year.

The Sterling 2017 Notes issued on 7 February 2017 mature on 7 February 2047 and bear interest at a rate of 4.875% per annum, payable annually in arrears on 7 February in each year.

Basic own fund items subject to transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC

As at 31 December 2018 Lloyd's does not have any own fund items subject to transitional arrangements.

During 2017 Lloyd's redeemed the Perpetual Subordinated Capital Securities issued in 2007 that were subject to the transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC.

These securities were issued before the Solvency II rules relating to such instruments were applicable and thus, in accordance with the Solvency II transitional rules, were 'grandfathered' for 10 years from 1 January 2016 at the tiering levels in accordance with the previous supervisory regime. Accordingly, they were treated as Tier 1 basic own funds. These were redeemed by Lloyd's at the first call date in June 2017.

Ancillary own funds – amount, method and counterparty details for items referred to in points (a), (b) and (c) of Article 89(1) of Directive 2009/138/EC

A significant proportion of Lloyd's own funds are provided in the form of ancillary own funds (AOF) provided within members' FAL.

AOF are subject to prior supervisory approval before they may be treated as available capital under Solvency II. Consistent with this, Lloyd's submitted an application to the PRA for approval of AOF in November 2018. The PRA subsequently granted approval of this application on 16 December 2018, amounting in total to £7,953m. The approval, including the conditions of subsequent valuations of AOF, was published in the PRA's written notice 5093015. The approval applies until 31 December 2022. This approval replaces a previous approval in this respect granted by the PRA in December 2017.

As set out in the written notice, the PRA provided approval in respect of 1,420 letters of credit, bank guarantees and insurance company guarantees ('guarantee items'), and 119 life policy items. Details of each counterparty are not disclosed in the written notice or the SFCR as they represent confidential arrangements between the member concerned and the counterparty providing the AOF instrument.

If any of the AOF items are called they would be converted into cash, a Tier 1 basic own funds item.

The table below summarises Lloyd's AOF and the valuation of these as at 31 December 2018 consistent with the valuation rules contained within the PRA's most recent approval of these. These amounts appear on template S.23.01 provided in Appendix 1.

Tier 2	Dec 2018	Dec 2017
	£m	£m
Letters of credit and guarantees in accordance with Article 96 (2) of Directive 2009/138/EC	7,633	9,427
Life policies	23	25
<b>Total ancillary own funds</b>	<b>7,656</b>	<b>9,452</b>

### Letters of credit and guarantees in accordance with Article 96 (2) of Directive 2009/138/EC

Certain members provide capital in the form of letters of credit and guarantees held in trust by Lloyd's to support FAL. This form of capital is consistent with 'letters of credit and guarantees which are held in trust for the benefit of insurance creditors by an independent trustee and provided by credit institutions authorised in accordance with Directive 2006/48/EC' (which is treated as Tier 2 capital per Article 96 (2) of the Directive).

### Letters of Credit (LOCs)

LOCs provided as FAL are in a Lloyd's standard form, and constitute a clean, irrevocable and unconditional standby credit which can be drawn down on demand. No substantive alterations to the form of the LOC can be made without consultation and notification to the PRA/FCA. Lloyd's has made conditions and requirements which must be met in order for a LOC to be admissible for FAL.

The parties to the LOC are Lloyd's (as beneficiary) and the approved credit institution. If the LOC has been confirmed by a UK credit institution (which would be the case if the issuing bank is outside of the UK) then Lloyd's contractual relationship will be with the confirming bank; if the LOC is not confirmed (because the issuing bank is in the UK), then Lloyd's contractual relationship will be with the issuing bank. Either way, both parties to the LOC will be in the UK. Moreover, all LOCs must be governed by English law and subject to the jurisdiction of the English court, as per the M&URs and the wording of the standard form LOC itself.

Some LOCs are provided on a syndicated basis, in which case Lloyd's would call on the agent bank. The contractual relationship is as described above.

### Guarantees

Guarantees provided as FAL are in a Lloyd's prescribed form, which cannot be changed without consultation with and notification to the PRA/FCA. Lloyd's has made conditions and requirements which must be met in order for a guarantee to be admissible for FAL. The process for drawing on a guarantee is slightly different to that for a LOC – the wording of the guarantee states that a demand can be made any time after the Principal (i.e. the member) is in default under the Security and Trust Deed under which the guarantee is held. The Principal would be in default if a demand for payment under the Trust Deed has been made and not met in accordance with its terms.

The parties to the guarantee are Lloyd's (as beneficiary) and the issuing entity.

In order to issue a guarantee an entity must be approved by Lloyd's – the criteria for approval include (inter alia) that a guarantee must be issued or confirmed out of London (although elsewhere in the UK (e.g. Manchester) has also been accepted). As with LOCs, this is a Lloyd's requirement and the wording of the guarantee itself states that the guarantee is subject to English law and the exclusive jurisdiction of the English court.

Sometimes a joint guarantee is provided in which case Lloyd's would call on the agent bank. The contractual relationship is as described above.

### Life policies

Certain members provide FAL in the form of life policies. Lloyd's sets out conditions for these to be eligible as FAL. These include that the policy is assigned to Lloyd's,

which is achieved through the execution by the member of a Deed of Assignment in favour of Lloyd's. Notice of the assignment is then given by Lloyd's to the life company which issued the policy, and acknowledgement of the same requested from the life company.

As a result of the assignment, the owner of the policy – as far as the life company is concerned – is Lloyd's. The relevant parties to the arrangement are therefore Lloyd's and the life company.

The life policies will be subject to the law of the jurisdiction in which they were issued, which in most cases will therefore be English law. In each case, Lloyd's requires the life company to advise which local jurisdiction the company is governed to transact life assurance business, and also to confirm that it is authorised to transact such business in the UK. The deed of assignment by which the policies are transferred to Lloyd's ownership are governed by English law and jurisdiction, and the assignment will have been acknowledged by the life company, and as such there are no concerns as to whether Lloyd's has properly acquired the benefit of them.

#### Items deducted from own funds and significant restrictions affecting availability and transferability of own funds

##### Foreseeable distributions

The amount of £388m (2017: £651m) reported on R0720 'Foreseeable dividends, distributions and charges' on template S.23.01 represents the net amount available to be distributed to inactive Lloyd's members in the capital tests. The capital test calculates the amount of funds that each member needs to hold at Lloyd's to cover its capital requirement and any underwriting liabilities. Only any excess over this amount is available for distribution to the member.

##### Ring fenced funds

Ring fenced funds arise where an asset is not considered to be freely available to meet all liabilities and thus must be deducted from available own funds. There are two areas where this arises at Lloyd's, in respect of certain syndicate overseas trust funds and Lloyd's China.

Lloyd's has conducted a review of syndicate overseas trust funds to assess whether any constitute a ring-fenced fund. Where this conclusion has been reached they are excluded from available own funds to meet the Lloyd's SCR. The amount in total in this respect is £477m (2017: £327m).

The value of the investments in Lloyd's China and Lloyd's Insurance Company SA (Lloyd's Brussels) have also been treated as ring-fenced funds as it is considered that these assets are not available to meet all Lloyd's insurance creditors on an unrestricted basis. The amount in total in this respect is £314m (2017: £127m).

The total of these amounts of £791m (2016: £454m) is as reported on R0740 at template S.23.01 in Appendix 1.

## **E.2 Solvency Capital Requirement\* and Minimum Capital Requirement**

### Amount of Solvency Capital Requirement\* and Minimum Capital Requirement

The table below shows the total SCR and MCR as at 31 December 2018.

	Dec 2018	Dec 2017
	£m	£m
Lloyd's MWSCR*	17,750	16,950
Lloyd's MCR	7,988	7,628
Central SCR*	1,400	1,600

The final amounts of the Lloyd's MWSCR and central SCR are subject to supervisory assessment.

Solvency Capital Requirement split by risk categories\*

The table below shows the risk categories that make up the Lloyd's MWSCR:

Component description	Dec 2018	Dec 2017
	£m	£m
Reserving risk	6,705	6,183
All other (attritional) underwriting risk	5,865	5,733
Catastrophe risk	2,972	3,923
Market risk	501	181
Reinsurance credit risk	597	523
Operational risk	739	728
Pension risk	22	14
<b>MWSCR before adjustments</b>	<b>17,401</b>	<b>17,285</b>
Foreign exchange adjustment to reflect the change in the value of the US dollar against sterling in the second half of the year	349	(335)
<b>MWSCR</b>	<b>17,750</b>	<b>16,950</b>

An analysis of the Lloyd's SCR by component as agreed with the PRA is provided at template S.25.03 (see Appendix 1). The material decrease in the catastrophe risk charge is due to increased use of reinsurance.

Simplified calculations used in standard formula

Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Undertaking specific parameters used in standard formula

Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Option provided for in third subparagraph of Article 51(2) of Directive 2009/138/EC

Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Impact of undertaking specific parameters required in accordance with Article 110 of Directive 2009/138/EC

Lloyd's SCR is calculated using an internal model thus this is not applicable to Lloyd's.

Inputs to calculate the Minimum Capital Requirement

The Lloyd's Minimum Capital Requirement has been calculated in accordance with the input elements as specified on template S.28.02 (see Appendix 1).



### Changes to the SCR\* and MCR during the reporting period

The MWSCR\*, central SCR\* and MCR as at 31 December 2018 and 31 December 2017 are summarised below:

	Dec 2018	Dec 2017
	£m	£m
MWSCR*	17,750	16,950
Central SCR*	1,400	1,600
MCR	7,988	7,628

Lloyd's conducts a substantial part of its business in US dollars. The main cause of the increase in the MWSCR is due to the significant appreciation of the US dollar against sterling during 2018. This has decreased the sterling value of the US dollar denominated elements of the SCR. This has also affected the central SCR, but is offset by the increased amount of member capital present in the market for the 2019 year of account. The increased amount of member capital serves to reduce the risk posed by members to the Central Fund, and so the Central SCR has reduced.

The MCR is calculated formulaically based on premiums and technical provisions. The value of these has increased due to the underwriting experience in 2018, particularly in respect of the major claims arising in Q3 and Q4 2018 thus resulting in an increase to the MCR.

### **E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement**

Lloyd's has not used this in the calculation of the SCR.

### **E.4 Differences between the standard formula and any internal model used\***

#### Uses of Lloyd's Internal Model (LIM)

The table below lists out the various purposes of the LIM

Use	Description
1. Calculate regulatory capital requirements for Lloyd's and support Lloyd's regulatory requirements	<p>The LIM is used to calculate the Solvency Capital Requirement (SCR). The LIM is used to calculate the Lloyd's Society SCR for:</p> <ul style="list-style-type: none"><li>i) the market as a whole; known as "Market Wide SCR";</li><li>ii) the Central Fund only; known as "Central SCR"</li></ul> <p>The Board output is a breakdown of the SCRs by risk type on a diversified and undiversified basis – however additional levels of granularity are sometimes used when interrogating the model or providing specific output for other model users.</p> <p>The LIM is also used to support the regulatory reporting requirements, where the use of output of the model is used to satisfy Solvency II Pillar 3 requirements (supervisory reporting and disclosure).</p>
2. Support the annual and quarterly Lloyd's Society ORSA,	<p>The ORSA is an ongoing process within Lloyd's contributed to by several Functions, culminating in quarterly annual reports to the Risk Committee and Board.</p>

Use	Description
including Stress and Scenario Testing	<p>It incorporates a series of processes which ensure an appropriate level and quality of capital is maintained to support the risks taken within Lloyd's on a current and future basis, in light of Lloyd's strategy set by the Board.</p> <p>The annual ORSA report pulls together information on the key risks, the capital and solvency position, stress and scenario testing and a forward-looking assessment of Lloyd's capital needs. The LIM is used to produce some of this information, either under one of the other uses or specifically for the annual ORSA.</p> <p>The quarterly ORSA report, produced for the Risk Committee and the Board, pulls together information on the key risks as well as the capital and solvency position of Lloyd's. The LIM is used to produce some of this information; either through one of the other uses or specifically for the quarterly ORSA report.</p>
3. Market event impact analysis	<p>The LIM is used to estimate the potential effect of an insurance event to the London Market.</p> <p>The Lloyd's Catastrophe Model (LCM) estimates gross claims from an event within the largest five region/perils. The LCM does not retain event level information when aggregating syndicates catastrophe risk into a Society view. However, using syndicate event level data feeding into the LCM it is possible to calculate a Society estimate of the claims from an event.</p>
4. Support monitoring of Lloyd's Society risk appetite	<p>Lloyd's risk appetite is an articulation of the level of risk-taking which the Board deems to be acceptable for Lloyd's.</p> <p>The risk appetite framework is the key tool used to monitor Lloyd's risk profile at a market and Corporation level. Risk appetite statements have been defined for each material risk area and are split according to whether they are Market or Corporation risks.</p> <p>All risk appetite metrics are reported to the Risk Committee and Board as part of the quarterly or annual ORSA. A number of the risk appetite metrics are produced using output from the LIM and use varying levels of granularity in LIM output, from high level SCR figures to individual risk type output (e.g. underwriting risk)</p>
5. Setting economic capital at a central level	<p>The LIM is also used to calculate the Economic Capital Requirements for Lloyd's at a central level.</p> <p>The central Economic Capital Requirement is calculated using the Central SCR, to ultimate, as a base. A series of buffers and allowances are then added/subtracted.</p>
6. Monitor and manage catastrophe exposures	<p>The LCM provides a probabilistic view of Lloyd's Catastrophe risk, estimating Lloyd's gross, net and final</p>

Use	Description
	<p>net (net plus reinstatements) loss to the material natural catastrophes for the Lloyd's Market.</p> <p>This is used to monitor the aggregate Market catastrophe risk and to assist in the review of syndicate's compliance within Lloyd's Minimum Standards with respect to Exposure Management.</p>
<p>7. Monitor and manage investment risk for Central Fund assets</p>	<p>Central Fund (CF) assets are invested centrally by Treasury &amp; Investment Management (LTIM) and LIRM is one of the primary tools used to support the management of investment risk for this portfolio. The CF risk appetite is expressed in the form of a value at risk (VAR) budget.</p> <p>LIRM is used to calculate VAR on a monthly basis, allowing LTIM to monitor and report on asset risk against appetite. LIRM is also used as a tool to inform and support investment decisions on an ad-hoc basis particularly where changes in strategy may have a material impact on portfolio level VAR.</p>
<p>8. Manage operational risk</p>	<p>This use supports two main areas:</p> <p>1) Operational risk scenarios approved by the Executive Risk Committee (ERC) informs the central Lloyd's SCR</p> <p>2) Oversight of Corporation operational risk by the ERC</p>

Scope of internal model in terms of business units and risk categories

The scope of Lloyd's internal model can be categorised into three areas:

- Syndicate risks;
- Member risks; and
- Corporation risks.

Syndicate risks

Syndicates are the source of the majority of risks. They are the source of all the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the operational day-to-day operational activity.

The syndicate risks include:

- Insurance risk;
  - Reserve risk;
  - Underwriting risk;
  - Natural catastrophe risk ("catastrophe risk");
  - All other risks ("attritional risk");
- Market risk;
  - On syndicate assets (including credit risk on Premiums Trust Funds);
  - On syndicate liabilities;
- Credit risk;
- Syndicate operational risk; and
- Liquidity risk.

Member risks

Members provide capital (FAL), in a variety of forms to support syndicates' risks; and present asset related risks which are dependent on characteristics of assets used to meet their FAL.

Members are exposed to market risk (including credit risk) on FAL.

#### Corporation risks

Central level risks include:

- Member deficits – arising from syndicate risks including Additional Central Fund risk (ACF);
- Central operational risk;
- Market risk (including credit risk) on central assets; and
- Pension fund risk resulting in deficit requiring funding from central assets.

#### Integration of the techniques to integrate any partial internal model with the standard formula

The LIM is a full internal model so this is not applicable.

#### Methods used for the calculation of the probability distribution forecast and the Solvency Capital Requirement

The LIM includes components and processes that are material to the risk and capital calculation within Lloyd's. It consists of three main component models:

- Capital Calculation Kernel (CCK);
- Lloyd's Catastrophe Model (LCM); and
- Lloyd's Investment Risk Model (LIRM).

The main element of the LIM is the Capital Calculation Kernel (CCK) which drives the capital calculation. It is a fully integrated Monte-Carlo simulation based stochastic model. The model is run with 100,000 simulations to ensure stability of results. The CCK represents the entire Lloyd's marketplace and models all material quantifiable risk types that the market is exposed to. These risks are modelled using Monte-Carlo simulation methods and are drawn together using the structure of the Lloyd's market. This allows the impacts of these risks to be quantified for different entities in the market place, namely syndicates, members and Central Fund.

The CCK builds a specific representation of each syndicate from the ground up using a generic structure, within a framework of dependency which determines how much diversification there is within and between syndicates. The generic structure calculates stochastic technical provisions, P&L, and balance sheet for the end of the 12-month period 'on risk'. The CCK then models how risk flows through the "chain of security", i.e. from syndicates to members to the Central Fund.

Insurance risk is modelled separately for attritional risk and natural catastrophe risk. For attritional risks, insurance losses are simulated by class of business and allocated to insurance risk for each syndicate after allowing for syndicate level volatility (SLV - previously known as syndicate noise). SLV is an additional random factor applied to allow for diversification between syndicates and the syndicates' class of business experience which will be more volatile compared to the market as a whole. As a result, syndicates will have different results and higher volatility than the market.

The catastrophe risk is defined by simulated losses imported from the LCM. SLV is not applied to natural catastrophe losses as the LCM captures syndicate variability and differences between syndicates directly. The LCM's core purpose is to take

syndicate Exceedance Probability (EP) curves and produce an aggregated Lloyd's view of natural catastrophe risk. The LCM aggregates losses across scenarios and applies loadings to ensure complete coverage of risks (e.g. uplifts for European windstorm clustering, secondary uncertainty and non-modelled risks) to produce the aggregated Lloyd's market view. For each simulation in the CCK, a scenario is picked at random for each of the five major perils, plus Rest of the World ("RoW") risks.

The LIRM models market risks as part of the LIM and consists of three core sub-components:

- Economic Scenario Generator (ESG) - an external model provided by Willis Towers Watson, which produces consistent stochastic scenarios of economic and financial variables;
- Asset Model - defines assets to be modelled, re-investment rules of the assets and calculates the distribution of total return for defined assets; and
- Portfolio Model - defines asset portfolios by combining modelled assets.

Once all loss types are aggregated in the LIM, if syndicate losses exceed Premiums Trust Funds (PTF) then the excess is allocated to members. If member losses exceed their FAL then the excess becomes a loss to the Central Fund. Risks relating to the Central Fund which are not considered at syndicate level are also added (operational, market risk on central assets and pension risk) to produce a central capital requirement.

#### Differences between standard formula and internal model

The LIM is a fully-integrated stochastic model. This method of calculating capital requirements is fundamentally different to the standard formula approach of deterministically combining stresses.

The LIM considers the unique nature and structure of the Lloyd's Market and the detailed risks to which it is exposed, which the standard formula is not able to do. This includes:

- Insurance Risk - Profit in plan: The standard formula makes no allowance for any expected profits in business plans (which can be significant);
- Catastrophe Risk: Allowance for catastrophe risk uses a combination of shocks and scenarios in the standard formula which is significantly less sophisticated than the LIM (and syndicate internal models);
- Market risk: The LIM (and most syndicates) use Economic Scenario Generators (ESGs) to determine their market risk compared to the shocks applied to assets and own funds in the standard formula;
- Diversification: the standard formula gives credit for diversification within each syndicate only (across class, geographical area and risk component). The LIM models the diversification across the market both within and between syndicates which have different exposures; and
- Structure: The Standard Formula does not capture the unique capital structure of Lloyd's and cannot provide a Central Fund capital requirement.

#### Risk measure and time-period used in the internal model

As set out in Article 101(3) of Directive 2009/138/EC, the SCR calculated using the internal model corresponds to the 99.5<sup>th</sup> Value-at-Risk over a one-year period.

#### Nature and appropriateness of data used in the internal model

The LIM uses various sources of data; this data is both internal (based on analyses performed by Lloyd's) and external. Data used within the internal model is subject to

the Lloyd's Data Quality Management Policy which requires checks and controls to be applied to the data. The purpose of this policy is to allow data owners to attest that it is accurate, appropriate and complete.

Data is subject to an annual audit of all controls and any associated risks arising from its use.

**E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement\***

Lloyd's has met the Lloyd's SCR, central SCR and MCR throughout the reporting period.

**E.6 Any other information**

There is no other material information to report.

## S.02.01.02

## Balance sheet

All figures shown in GBP '000

		Solvency II value
		C0010
<b>Assets</b>		
Goodwill	R0010	
Deferred acquisition costs	R0020	
Intangible assets	R0030	0
Deferred tax assets	R0040	31,486
Pension benefit surplus	R0050	0
Property, plant & equipment held for own use	R0060	0
Investments (other than assets held for index-linked and unit-linked contracts)	R0070	60,784,878
Property (other than for own use)	R0080	0
Holdings in related undertakings, including participations	R0090	18,849
Equities	R0100	2,506,781
Equities - listed	R0110	2,230,917
Equities - unlisted	R0120	275,864
Bonds	R0130	47,975,483
Government Bonds	R0140	20,764,334
Corporate Bonds	R0150	23,225,791
Structured notes	R0160	12,060
Collateralised securities	R0170	3,973,298
Collective Investments Undertakings	R0180	8,600,841
Derivatives	R0190	90,806
Deposits other than cash equivalents	R0200	1,592,120
Other investments	R0210	0
Assets held for index-linked and unit-linked contracts	R0220	0
Loans and mortgages	R0230	237,678
Loans on policies	R0240	0
Loans and mortgages to individuals	R0250	54,837
Other loans and mortgages	R0260	182,841
Reinsurance recoverables from:	R0270	13,995,885
Non-life and health similar to non-life	R0280	13,886,681
Non-life excluding health	R0290	13,592,151
Health similar to non-life	R0300	294,530
Life and health similar to life, excluding health and index-linked and unit-linked	R0310	109,203
Health similar to life	R0320	30,164
Life excluding health and index-linked and unit-linked	R0330	79,039
Life index-linked and unit-linked	R0340	0
Deposits to cedants	R0350	96,043
Insurance and intermediaries receivables	R0360	2,197,322
Reinsurance receivables	R0370	3,027,838
Receivables (trade, not insurance)	R0380	971,607
Own shares (held directly)	R0390	0
Amounts due in respect of own fund items or initial fund called up but not yet paid in	R0400	0
Cash and cash equivalents	R0410	2,433,525
Any other assets, not elsewhere shown	R0420	476,725
<b>Total assets</b>	<b>R0500</b>	<b>84,252,986</b>

<b>Liabilities</b>		
Technical provisions – non-life	R0510	58,260,018
Technical provisions – non-life (excluding health)	R0520	55,931,282
Technical provisions calculated as a whole	R0530	0
Best Estimate	R0540	52,697,750
Risk margin	R0550	3,233,532
Technical provisions - health (similar to non-life)	R0560	2,328,736
Technical provisions calculated as a whole	R0570	0
Best Estimate	R0580	2,185,257
Risk margin	R0590	143,480
Technical provisions - life (excluding index-linked and unit-linked)	R0600	414,116
Technical provisions - health (similar to life)	R0610	60,219
Technical provisions calculated as a whole	R0620	0
Best Estimate	R0630	55,967
Risk margin	R0640	4,252
Technical provisions – life (excluding health and index-linked and unit-linked)	R0650	353,897
Technical provisions calculated as a whole	R0660	0
Best Estimate	R0670	305,566
Risk margin	R0680	48,332
Technical provisions – index-linked and unit-linked	R0690	0
Technical provisions calculated as a whole	R0700	0
Best Estimate	R0710	0
Risk margin	R0720	0
Other technical provisions	R0730	
Contingent liabilities	R0740	0
Provisions other than technical provisions	R0750	33,358
Pension benefit obligations	R0760	90,012
Deposits from reinsurers	R0770	387,864
Deferred tax liabilities	R0780	0
Derivatives	R0790	102,274
Debts owed to credit institutions	R0800	223,172
Financial liabilities other than debts owed to credit institutions	R0810	0
Insurance & intermediaries payables	R0820	1,240,809
Reinsurance payables	R0830	1,100,489
Payables (trade, not insurance)	R0840	1,696,743
Subordinated liabilities	R0850	822,368
Subordinated liabilities not in Basic Own Funds	R0860	0
Subordinated liabilities in Basic Own Funds	R0870	822,368
Any other liabilities, not elsewhere shown	R0880	942,484
<b>Total liabilities</b>	<b>R0900</b>	<b>65,313,708</b>
<b>Excess of assets over liabilities</b>	<b>R1000</b>	<b>18,939,278</b>



5.05.01.02

Premiums, claims and expenses by line of business

5.05.01.02.01

Z Axis:  
VG/Statutory accounts  
DI/Year to Date

Non-Life (direct business/accepted proportional reinsurance and accepted non-proportional reinsurance)

	Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)																Line of Business for: accepted non-proportional reinsurance					Total
	Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Health	Casualty	Marine, aviation, transport	Property						
	C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0200					
<b>Premiums written</b>																						
Gross - Direct Business	R0110	357,763	885,497	205,211	498,402	553,814	4,040,622	8,497,111	8,233,263	907,343	90,666	26,807	340,449					24,636,946				
Gross - Proportional reinsurance accepted	R0120	27,297	72,104	61,145	138,659	4,229	794,460	2,851,293	591,579	230,841	1,704	8,043	24,004					4,005,788				
Gross - Non-proportional reinsurance accepted	R0130																					
Reinsurers' share	R0140	79,883	159,622	83,063	115,168	69,166	1,322,289	3,057,539	2,432,015	297,941	29,993	4,266	87,259	359,649	1,482,413	1,420,723	5,220,923	8,483,707				
Net	R0200	305,178	797,979	183,292	488,877	521,893	488,877	7,490,865	6,392,824	840,244	62,377	30,584	277,595					26,658,689				
<b>Premiums earned</b>																						
Gross - Direct Business	R0210	349,336	841,720	207,459	480,663	566,602	4,248,130	8,247,728	7,743,847	834,350	90,051	28,775	300,590					23,939,250				
Gross - Proportional reinsurance accepted	R0220	32,134	76,630	63,758	95,043	3,860	750,539	1,962,917	670,272	230,740	1,065	5,187	24,677					3,916,823				
Gross - Non-proportional reinsurance accepted	R0230																					
Reinsurers' share	R0240	81,882	152,036	85,153	121,212	76,115	1,351,716	2,925,546	2,286,911	283,364	29,226	4,010	78,627	358,055	1,456,939	1,499,692	5,106,778	8,421,463				
Net	R0300	299,588	766,314	186,064	454,495	494,347	3,646,892	7,285,100	6,127,209	781,727	61,889	20,952	246,640					26,132,704				
<b>Claims incurred</b>																						
Gross - Direct Business	R0310	217,771	451,866	191,321	206,453	308,252	2,704,732	6,139,950	5,614,588	379,666	36,383	18,426	176,253					16,445,161				
Gross - Proportional reinsurance accepted	R0320	25,264	49,016	59,245	59,350	3,217	393,213	1,397,415	510,689	153,884	2,300	20,988						2,873,283				
Gross - Non-proportional reinsurance accepted	R0330																					
Reinsurers' share	R0340	54,976	88,362	110,360	56,036	78,857	2,477,231	2,372,231	148,659	24,168	1,880	64,276	170,486	1,071,728	763,914	4,887,733	6,893,861					
Net	R0400	187,559	412,520	140,206	338,361	255,433	2,313,089	5,260,133	3,753,046	384,891	34,515	18,246	132,966					17,084,578				
<b>Changes in other technical provisions</b>																						
Gross - Direct Business	R0410																					
Gross - Proportional reinsurance accepted	R0420																					
Gross - Non-proportional reinsurance accepted	R0430																					
Reinsurers' share	R0440																					
Net	R0500																					
<b>Expenses incurred</b>	R0550	140,280	372,614	61,607	172,575	187,762	1,494,693	3,195,879	2,488,132	311,717	48,575	12,085	99,606	112,898	373,872	387,940	1,186,242	10,646,478				
<b>Other expenses</b>	R1200																	54,981				
<b>Total expenses</b>	R1300																	10,701,459				

5.05.01.02.02

Z Axis:  
VG/Statutory accounts  
DI/Year to Date

Life

	Line of Business for: life insurance obligations						Life reinsurance obligations			Total
	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Annuitants stemming from non-life insurance contracts and relating to health insurance obligations	Annuitants stemming from non-life insurance contracts and relating to insurance obligations other than health insurance obligations	Health reinsurance	Life-reinsurance		
	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0300	
<b>Premiums written</b>										
Gross	R1410	-	-	-	88,563	-	-	-	8,153	96,716
Reinsurers' share	R1420	-	-	-	21,398	-	-	-	82	21,472
Net	R1500	-	-	-	67,175	-	-	-	8,071	75,244
<b>Premiums earned</b>										
Gross	R1510	-	-	-	96,999	-	-	-	6,353	103,353
Reinsurers' share	R1520	-	-	-	22,273	-	-	-	2,509	19,764
Net	R1600	-	-	-	74,726	-	-	-	3,844	83,580
<b>Claims incurred</b>										
Gross	R1610	-	-	-	48,874	4,052	6,242	-	16,390	75,558
Reinsurers' share	R1620	-	-	-	16,100	467	1,603	-	524	18,694
Net	R1700	-	-	-	32,774	3,585	7,845	-	15,866	59,660
<b>Changes in other technical provisions</b>										
Gross	R1710	-	-	-	-	-	-	-	-	-
Reinsurers' share	R1720	-	-	-	-	-	-	-	-	-
Net	R1800	-	-	-	-	-	-	-	-	-
<b>Expenses incurred</b>	R1900	-	-	-	38,855	1,045	134	-	1,686	31,720
<b>Other expenses</b>	R2500	-	-	-	-	-	-	-	-	5
<b>Total expenses</b>	R2600	-	-	-	38,855	1,045	134	-	1,686	31,725

S.05.02.01

Premiums, claims and expenses by country  
All figures shown in GBP '000

S.05.02.01.01

Home Country - non-life obligations

		Home country - United Kingdom
		C0080
<b>Premiums written</b>		
Gross - Direct Business	R0110	9,949,529
Gross - Proportional reinsurance accepted	R0120	1,318,801
Gross - Non-proportional reinsurance accepted	R0130	2,628,232
Reinsurers' share	R0140	4,071,998
Net	R0200	9,824,564
<b>Premiums earned</b>		
Gross - Direct Business	R0210	9,759,500
Gross - Proportional reinsurance accepted	R0220	1,327,312
Gross - Non-proportional reinsurance accepted	R0230	2,553,000
Reinsurers' share	R0240	4,009,343
Net	R0300	9,630,469
<b>Claims incurred</b>		
Gross - Direct Business	R0310	6,481,816
Gross - Proportional reinsurance accepted	R0320	941,349
Gross - Non-proportional reinsurance accepted	R0330	2,059,372
Reinsurers' share	R0340	3,433,944
Net	R0400	6,048,592
<b>Changes in other technical provisions</b>		
Gross - Direct Business	R0410	0
Gross - Proportional reinsurance accepted	R0420	0
Gross - Non-proportional reinsurance accepted	R0430	0
Reinsurers' share	R0440	0
Net	R0500	0
Expenses incurred	R0550	4,096,425
Other expenses	R1200	
Total expenses	R1300	

S.05.02.01.04

Home Country - life obligations

		Home country - United Kingdom
		C0220
<b>Premiums written</b>		
Gross	R1410	52,921
Reinsurers' share	R1420	9,378
Net	R1500	43,543
<b>Premiums earned</b>		
Gross	R1510	60,901
Reinsurers' share	R1520	7,098
Net	R1600	53,803
<b>Claims incurred</b>		
Gross	R1610	40,343
Reinsurers' share	R1620	4,528
Net	R1700	35,815
<b>Changes in other technical provisions</b>		
Gross	R1710	0
Reinsurers' share	R1720	0
Net	R1800	0
Expenses incurred	R1900	20,910
Other expenses	R2500	
Total expenses	R2600	

S.05.02.01.02

Top 5 countries (by amount of gross premiums written) - non-life obligations

USA	Canada	Australia	Bermuda	Japan
C0090	C0091	C0092	C0093	C0094
7,812,491	1,242,408	819,153	83,085	60,537
955,809	43,075	39,875	425,263	53,320
2,857,749	114,466	133,756	414,607	111,580
3,246,776	292,157	227,268	246,347	77,576
8,379,273	1,107,792	765,516	676,608	147,862
7,379,118	1,244,748	766,971	71,711	59,719
935,623	46,449	40,262	383,002	58,328
2,771,400	116,308	178,741	444,534	131,596
3,054,256	274,789	204,176	230,319	84,418
8,031,885	1,132,716	781,798	668,928	165,226
5,150,288	831,341	572,726	75,878	18,814
865,602	35,953	-44,260	321,360	-30,132
2,579,323	36,325	43,038	464,071	238,504
3,135,713	253,241	155,293	219,416	95,357
5,459,500	650,378	416,211	641,893	131,828
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
3,291,810	440,192	292,969	146,491	68,108

S.05.02.01.05

Top 5 countries (by amount of gross premiums written) - life obligations

USA	Norway	Italy	Mexico	Switzerland
C0230	C0231	C0232	C0233	C0234
30,158	1,911	1,299	154	71
8,943	390	266	25	10
21,215	1,521	1,033	129	61
28,748	2,600	1,360	159	55
9,429	434	285	17	4
19,319	2,166	1,075	143	51
25,983	2,056	603	13	150
8,547	306	235	6	1
17,435	1,750	367	7	149
0	0	0	0	0
0	0	0	0	0
0	0	0	0	0
6,918	634	365	89	45

S.05.02.01.03

Total Top 5 and home country - non-life obligations

Total Top 5 and home country
C0140
19,967,204
2,836,143
6,260,389
8,162,121
20,901,615
19,281,767
2,790,977
6,195,578
7,857,301
20,411,021
13,130,864
2,089,871
5,420,632
7,292,964
13,348,403
0
0
0
0
0
8,335,996
49,122
8,385,117

S.05.02.01.06

Total Top 5 and home country - life obligations

Total Top 5 and home country
C0280
86,515
19,012
67,503
93,822
17,266
76,556
69,148
13,623
55,524
0
0
0
28,959
5
28,964

S.12.01.02  
 Life and Health SLT Technical Provisions  
 All figures shown in GBP '000

		Index-linked and unit-linked insurance				Other life insurance			Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance obligations	Accepted reinsurance	Total (Life other than health insurance, incl. Unit-Linked)	Health insurance (direct business)			Annuities stemming from non-life insurance contracts and relating to health insurance obligations	Health reinsurance (reinsurance accepted)	Total (Health similar to life insurance)		
		Insurance with profit participation	Contracts without options and guarantees		Contracts with options or guarantees	Contracts without options and guarantees	Contracts with options or guarantees	C0090				C0100	C0150	Contracts without options and guarantees				C0180	
			C0020	C0030										C0040					C0050
Technical provisions calculated as a whole	R0010	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0		
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	R0020	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0		
Technical provisions calculated as a sum of BE and RM																			
Best Estimate																			
Gross Best Estimate	R0030	0	0	0	0	0	34,013	0	263,408	8,144	305,566	0	0	0	55,967	0	55,967		
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0080	0	0	0	0	0	-9,748	0	90,850	-2,063	79,039	0	0	0	30,164	0	30,164		
Best estimate minus recoverables from reinsurance/SPV and Finite Re - total	R0090	0	0	0	0	0	43,762	0	172,558	10,207	226,527	0	0	0	25,803	0	25,803		
Risk Margin	R0100	0	0	0	0	4,367	0	0	42,750	1,215	48,332	0	0	0	4,252	0	4,252		
Amount of the transitional on Technical Provisions																			
Technical Provisions calculated as a whole	R0110	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0		
Best estimate	R0120	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0		
Risk margin	R0130	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0		
Technical provisions - total	R0200	0	0	0	0	38,380	0	0	306,158	9,359	353,897	0	0	0	60,219	0	60,219		

		Direct business and accepted proportional reinsurance											Accepted non-proportional reinsurance				Total Non-Life obligation	
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance		Non-proportional property reinsurance
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160		C0170
<b>Technical provisions calculated as a whole</b>	R0010	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole	R0050	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Technical provisions calculated as a sum of BE and RM</b>																		
<b>Best estimate</b>																		
<u>Premium provisions</u>																		
Gross	R0060	21,610	20,192	27,671	119,162	91,043	212,372	966,070	998,382	-50,684	2,842	4,464	-13,884	-13,799	52,585	42,548	-204,541	2,276,033
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0140	-2,177	-36,639	-7,744	-5,769	-4,583	-248,288	-560,576	-82,361	-99,661	1,256	-210	-41,937	-6,143	-10,768	-101,765	-430,489	-1,637,855
Net Best Estimate of Premium Provisions	R0150	23,787	56,831	35,416	124,931	95,627	460,660	1,526,647	1,080,744	48,977	1,586	4,675	28,053	-7,657	63,352	144,313	225,948	3,913,888
<u>Claims provisions</u>																		
Gross	R0160	126,160	637,381	689,178	1,119,891	323,738	6,925,378	9,367,740	17,286,140	1,109,058	55,203	8,726	370,241	676,864	4,462,839	2,637,963	6,810,473	52,606,974
Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	R0240	10,970	76,010	172,968	437,660	69,141	1,893,190	3,192,655	4,734,080	224,835	15,462	2,115	106,036	87,285	611,758	878,753	3,011,618	15,524,537
Net Best Estimate of Claims Provisions	R0250	115,190	561,371	516,210	682,231	254,597	5,032,188	6,175,085	12,552,060	884,223	39,741	6,610	264,205	589,579	3,851,081	1,759,209	3,798,855	37,082,437
<b>Total Best estimate - gross</b>	R0260	147,770	657,573	716,850	1,239,053	414,782	7,137,750	10,333,811	18,284,523	1,058,374	58,046	13,190	356,357	663,065	4,515,423	2,680,510	6,605,932	54,883,007
<b>Total Best estimate - net</b>	R0270	138,977	618,201	551,626	807,162	350,224	5,492,848	7,701,731	13,632,804	933,200	41,328	11,285	292,258	581,922	3,914,433	1,903,522	4,024,803	40,996,326
<b>Risk margin</b>	R0280	12,083	46,070	46,674	49,849	32,253	407,781	573,522	1,185,452	98,855	2,525	525	18,087	38,654	344,026	150,720	369,936	3,377,011
<b>Amount of the transitional on Technical Provisions</b>																		
Technical Provisions calculated as a whole	R0290	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Best estimate	R0300	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Risk margin	R0310	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Technical provisions - total</b>																		
Technical provisions - total	R0320	159,853	703,642	763,523	1,288,902	447,035	7,545,530	10,907,333	19,469,975	1,157,229	60,571	13,715	374,443	701,718	4,859,449	2,831,230	6,975,868	58,260,018
Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total	R0330	8,793	39,371	165,224	431,891	64,557	1,644,902	2,632,079	4,651,719	125,174	16,718	1,905	64,099	81,142	600,990	776,988	2,581,129	13,886,681
Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total	R0340	151,060	664,271	598,299	857,012	382,477	5,900,628	8,275,254	14,818,256	1,032,055	43,853	11,810	310,345	620,576	4,258,459	2,054,242	4,394,740	44,373,337

S.19.01.21

Non-life insurance claims  
All figures shown in GBP '000

S.19.01.21.01

Gross Claims Paid (non-cumulative) - Development year (absolute amount)

		0	1	2	3	4	5	6	7	8	9	10 & +
		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110
Prior	R0100											560,287
N-9	R0160	1,319,420	3,509,974	2,220,294	1,244,191	867,789	609,495	596,353	203,413	176,367	154,428	
N-8	R0170	1,615,666	4,681,722	3,778,307	2,121,359	1,299,364	922,462	652,893	381,428	182,844		
N-7	R0180	2,205,123	4,431,731	3,220,039	1,919,667	1,114,601	723,413	555,694	372,196			
N-6	R0190	1,478,374	3,817,172	2,930,086	1,760,723	1,112,979	779,392	535,748				
N-5	R0200	1,497,778	3,895,348	3,176,802	1,596,824	914,470	717,856					
N-4	R0210	1,076,775	3,953,458	3,120,963	2,103,352	1,182,243						
N-3	R0220	877,383	4,158,175	3,543,486	2,016,447							
N-2	R0230	1,404,387	5,531,499	4,879,695								
N-1	R0240	2,992,744	8,619,437									
N	R0250	1,817,594										

S.19.01.21.03

Gross undiscounted Best Estimate Claims Provisions - Development year (absolute amount)

		0	1	2	3	4	5	6	7	8	9	10 & +
		C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0350
Prior	R0100											3,441,010
N-9	R0160	0	0	0	0	0	67,832	59,750	437,559	891,683	902,273	
N-8	R0170	0	0	0	0	115,533	67,116	1,452,086	1,175,343	1,160,211		
N-7	R0180	0	0	0	157,399	136,669	1,750,355	1,505,565	1,420,264			
N-6	R0190	0	0	247,300	229,925	3,055,590	2,244,305	2,019,592				
N-5	R0200	0	348,483	308,337	3,714,780	3,013,078	2,599,776					
N-4	R0210	255,608	532,027	6,299,395	4,281,371	4,353,044						
N-3	R0220	351,026	8,490,646	6,689,112	5,772,382							
N-2	R0230	5,708,851	11,306,309	8,934,434								
N-1	R0240	11,114,748	15,159,338									
N	R0250	9,785,738										

S.19.01.21.02

Gross Claims Paid (non-cumulative) - Current year, sum of years (cumulative). Total

		In Current year	Sum of years (cumulative)
		C0170	C0180
Prior	R0100	560,287	60,935,913
N-9	R0160	154,428	10,901,723
N-8	R0170	182,844	15,636,044
N-7	R0180	372,196	14,542,464
N-6	R0190	535,748	12,414,475
N-5	R0200	717,856	11,799,078
N-4	R0210	1,182,243	11,436,790
N-3	R0220	2,016,447	10,595,489
N-2	R0230	4,879,695	11,815,582
N-1	R0240	8,619,437	11,612,180
N	R0250	1,817,594	1,817,594
Total	R0260	21,038,774	173,507,332

S.19.01.21.04

Gross discounted Best Estimate Claims Provisions - Current year, sum of years (cumulative)

		Year end (discounted data)
		C0360
Prior	R0100	3,206,431
N-9	R0160	844,013
N-8	R0170	1,095,131
N-7	R0180	1,325,144
N-6	R0190	1,908,198
N-5	R0200	2,459,187
N-4	R0210	4,144,828
N-3	R0220	5,459,288
N-2	R0230	8,479,087
N-1	R0240	14,424,936
N	R0250	9,290,964
Total	R0260	52,637,207

## S.23.01.01

## Own funds

All figures shown in GBP '000

## S.23.01.01.01

## Own funds

		Total C0010	Tier 1 - unrestricted C0020	Tier 1 - restricted C0030	Tier 2 C0040	Tier 3 C0050
<b>Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35</b>						
Ordinary share capital (gross of own shares)	R0010					
Share premium account related to ordinary share capital	R0030					
Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings	R0040	23,524,074	23,524,074			
Subordinated mutual member accounts	R0050					
Surplus funds	R0070					
Preference shares	R0090					
Share premium account related to preference shares	R0110					
Reconciliation reserve	R0130	-5,795,249	23,524,074			
Subordinated liabilities	R0140	822,368			822,368	
An amount equal to the value of net deferred tax assets	R0160	31,486				31,486
Other own fund items approved by the supervisory authority as basic own funds not specified above	R0180					
<b>Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds</b>						
Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds	R0220					
<b>Deductions</b>						
Deductions for participations in financial and credit institutions	R0230					
<b>Total basic own funds after deductions</b>	R0290	18,582,679	17,728,825	0	822,368	31,486
<b>Ancillary own funds</b>						
Unpaid and uncalled ordinary share capital callable on demand	R0300					
Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual-type undertakings, callable on demand	R0310					
Unpaid and uncalled preference shares callable on demand	R0320					
A legally binding commitment to subscribe and pay for subordinated liabilities on demand	R0330					
Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC	R0340	7,632,846			7,632,846	
Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC	R0350					
Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0360					
Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC	R0370					
Other ancillary own funds	R0390	23,359			23,359	
<b>Total ancillary own funds</b>	R0400	7,656,206			7,656,206	
<b>Available and eligible own funds</b>						
Total available own funds to meet the SCR	R0500	26,238,884	17,728,825	0	8,478,574	31,486
Total available own funds to meet the MCR	R0510	18,551,193	17,728,825	0	822,368	
Total eligible own funds to meet the SCR	R0540	26,238,884	17,728,825	0	8,478,574	31,486
Total eligible own funds to meet the MCR	R0550	18,551,193	17,728,825	0	822,368	
<b>SCR</b>	R0580	17,750,000				
<b>MCR</b>	R0600	7,987,500				
<b>Ratio of Eligible own funds to SCR</b>	R0620	1.4765				
<b>Ratio of Eligible own funds to MCR</b>	R0640	2.3225				

## S.23.01.01.02

## Reconciliation reserve

		C0060
<b>Reconciliation reserve</b>		
Excess of assets over liabilities	R0700	18,939,278
Own shares (held directly and indirectly)	R0710	0
Foreseeable dividends, distributions and charges	R0720	388,000
Other basic own fund items	R0730	23,555,527
Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds	R0740	791,000
<b>Reconciliation reserve</b>	R0760	-5,795,249
<b>Expected profits</b>		
Expected profits included in future premiums (EPIFP) - Life business	R0770	7,103
Expected profits included in future premiums (EPIFP) - Non-life business	R0780	3,348,853
<b>Total Expected profits included in future premiums (EPIFP)</b>	R0790	3,355,956

S.25.03.21

Solvency Capital Requirement - for undertakings on Full Internal Models

All figures shown in GBP '000

S.25.03.01.01

Component-specific information

Unique number of component	Components Description	Calculation of the Solvency Capital Requirement
C0010	C0020	C0030
10300I	Other interest rate risk	-36,219
10400I	Equity risk	2,621,118
10700I	Spread risk	2,677,789
10900I	Currency risk	8,085,857
11000I	Other market risk	2,577,978
19900I	Diversification within market risk	-8,962,764
20100I	Type 1 counterparty risk (reinsurance credit risk)	960,115
20310I	Other counterparty risk (asset default)	1,253,136
29900I	Diversification within counterparty risk	-765,425
30000I	Total life underwriting risk (sum of syndicate's life SCRs)	161,000
40800I	Health NSLT medical expenses	203,027
40900I	Health NSLT income protection	359,180
41000I	Health NSLT worker's compensation	219,635
41100I	Health NSLT non-proportional reinsurance	338,970
49900I	Diversification within health underwriting risk	-280,883
50150I	Premium risk	6,105,712
50210I	Reserve risk	11,219,366
50300I	Non-life catastrophe risk : natural (i.e. meteorological and geological)	8,247,759
59900I	Diversification within non-life underwriting risk	-9,717,379
70100I	Operational risk	765,946
80100I	Other risks including pension risk, ACF, and FX adjustment	1,522,987

S.25.03.01.02

Calculation of Solvency Capital Requirement

		C0100
Total undiversified components	R0110	27,556,906
Diversification	R0060	-9,806,906
Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC (transitional)	R0160	
<b>Solvency capital requirement excluding capital add-on</b>	R0200	<b>17,750,000</b>
Capital add-ons already set	R0210	
Solvency capital requirement	R0220	17,750,000
<b>Other information on SCR</b>		
Amount/estimate of the overall loss-absorbing capacity of technical provisions	R0300	
Amount/estimate of the overall loss-absorbing capacity of deferred taxes	R0310	
Total amount of Notional Solvency Capital Requirements for remaining part	R0410	17,750,000
Total amount of Notional Solvency Capital Requirement for ring fenced funds	R0420	
Total amount of Notional Solvency Capital Requirement for matching adjustment portfolios	R0430	
Diversification effects due to RFF nSCR aggregation for article 304	R0440	

**S.28.02.01**  
**Minimum Capital Requirement - Both life and non-life insurance activity**  
**All figures shown in GBP '000**

**S.28.02.01.01**

**MCR components**

		MCR components	
		Non-life activities	Life activities
		MCR <sub>Non-life</sub> Result	MCR <sub>Life</sub> Result
		C0010	C0020
Linear formula component for non-life insurance and reinsurance obligations	R0010	8,081,684	

**S.28.02.01.02**

**Z Axis:**

**VG/Solvency II**

**Background information**

		Background information			
		Non-life activities		Life activities	
		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
		C0030	C0040	C0050	C0060
Medical expense insurance and proportional reinsurance	R0020	143,334	234,799		
Income protection insurance and proportional reinsurance	R0030	621,267	667,941		
Workers' compensation insurance and proportional reinsurance	R0040	551,710	191,797		
Motor vehicle liability insurance and proportional reinsurance	R0050	808,104	570,360		
Other motor insurance and proportional reinsurance	R0060	354,971	463,555		
Marine, aviation and transport insurance and proportional reinsurance	R0070	5,233,567	3,420,360		
Fire and other damage to property insurance and proportional reinsurance	R0080	7,748,383	7,146,707		
General liability insurance and proportional reinsurance	R0090	13,656,703	6,340,800		
Credit and suretyship insurance and proportional reinsurance	R0100	983,904	836,215		
Legal expenses insurance and proportional reinsurance	R0110	41,894	27,285		
Assistance and proportional reinsurance	R0120	11,285	23,987		
Miscellaneous financial loss insurance and proportional reinsurance	R0130	294,166	318,973		
Non-proportional health reinsurance	R0140	582,579	214,117		
Non-proportional casualty reinsurance	R0150	3,617,390	953,148		
Non-proportional marine, aviation and transport reinsurance	R0160	1,922,113	1,003,187		
Non-proportional property reinsurance	R0170	4,050,289	2,835,439		

**S.28.02.01.03**

**Linear formula component for life insurance and reinsurance obligations**

		Non-life activities	Life activities
		MCR <sub>Non-life</sub> Result	MCR <sub>Life</sub> Result
		C0070	C0080
Linear formula component for life insurance and reinsurance obligations	R0200	24,000	
		LE/Non-life activity	LE/Life activity

**S.28.02.01.04**

**Z Axis:**

**VG/Solvency II**

**Total capital at risk for all life (re)insurance obligations**

		Non-life activities		Life activities	
		Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk	Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
		C0090	C0100	C0110	C0120
Obligations with profit participation - guaranteed benefits	R0210				
Obligations with profit participation - future discretionary benefits	R0220				
Index-linked and unit-linked insurance obligations	R0230				
Other life (re)insurance and health (re)insurance obligations	R0240			252,332	
Total capital at risk for all life (re)insurance obligations	R0250				26,715,985

**S.28.02.01.05**

**Z Axis:**

**VG/Solvency II**

**Overall MCR calculation**

		C0130
Linear MCR	R0300	8,105,684
SCR	R0310	17,750,000
MCR cap	R0320	7,987,500
MCR floor	R0330	4,437,500
Combined MCR	R0340	7,987,500
Absolute floor of the MCR	R0350	3,333
Minimum Capital Requirement	R0400	7,987,500

**S.28.02.01.06**

**Z Axis:**

**VG/Solvency II**

**Notional non-life and life MCR calculation**

		Non-life activities	Life activities
		C0140	C0150
Notional linear MCR	R0500		
Notional SCR excluding add-on (annual or latest calculation)	R0510		
Notional MCR cap	R0520		
Notional MCR floor	R0530		
Notional Combined MCR	R0540		
Absolute floor of the notional MCR	R0550		
Notional MCR	R0560		





**Independent Reasonable Assurance Report of PricewaterhouseCoopers LLP to the Council of Lloyd's Report on the preparation of relevant elements of the Solvency Financial Condition Report under Pillar 3 of Solvency II for the association of underwriters known as Lloyd's as at 31 December 2018.**

**Conclusion**

In our opinion the Council of Lloyd's has prepared the information subject to assurance in the Relevant elements of the Solvency Financial Condition Report (as defined below) under Pillar 3 of Solvency II for the association of underwriters known as Lloyd's ('Lloyd's') as at 31 December 2018, defined below, in all material respects in accordance with the reporting basis of preparation (the 'Lloyd's basis of preparation').

This opinion is to be read in the context of what we say in the remainder of this report.

**What we have assured**

Except as noted below, we have assured the 'Relevant elements of the Solvency and Financial Condition Report', which is prepared by the Council of Lloyd's, comprises:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of Lloyd's as at 31 December 2018, ('the Narrative Disclosures subject to reasonable assurance'); and
- Lloyd's templates S.02.01.02, S.12.01.02, S.17.01.02, S.23.01.01 and S.28.02.01 ('the Templates subject to reasonable assurance')

The Relevant elements of the Solvency and Financial Condition Report have been compiled in part from an aggregation of financial information extracted from the corresponding Solvency II information included in syndicates' Annual Solvency Returns by the managing agent of each syndicate, which have been submitted to the Council of Lloyd's and on which the auditors of each syndicate have reported. Our work did not involve assessing the quality of those audits or performing any audit procedures over the financial or other information of the syndicates or provided by the managing agents of the syndicates.

**Professional standards applied and level of assurance**

We performed a reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised) – 'Assurance Engagements other than Audits or Reviews of Historical Financial Information', issued by the International Auditing and Assurance Standards Board (IAASB).

Our examination has consisted principally of:

- obtaining an understanding of the process used by the Council of Lloyd's to compile the relevant elements of the Solvency and Financial Condition Report from the financial records of the Society of Lloyd's, of Funds at Lloyd's and from the audited syndicate Annual Solvency Returns, prepared by the managing agent of each syndicate;

*PricewaterhouseCoopers LLP, 7 More London Riverside, London, SE1 2RT  
T: +44 (0) 2075 835 000, F: +44 (0) 2072 127 500, www.pwc.co.uk*

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Conduct Authority for designated investment business.



- checking (on a sample basis) that the financial information included in the Relevant elements of the Solvency and Financial Condition Report for syndicates was correctly extracted from the audited syndicate Annual Solvency Return;
- checking (on a sample basis) that the financial information included in the Relevant elements of the Solvency and Financial Condition Report for the Society of Lloyd's was correctly extracted from the Society of Lloyd's IFRS financial statements, and that adjustments were made by Lloyd's for presentation and classification differences between IFRS and Solvency II, in line with the Lloyd's basis of preparation;
- checking (on a sample basis) that the financial information included in the relevant elements of the Solvency and Financial Condition Report for Funds at Lloyd's was correctly extracted from the Lloyd's Pro Forma Financial Statements (the 'PFFS'), and that adjustments were made by Lloyd's for presentation and classification differences between the basis of preparation of the PFFS and Solvency II, in line with the Lloyd's basis of preparation; and
- evaluating evidence (on a sample basis) to support the completeness and accuracy of management's reconciliation of the Ancillary Own Funds in the relevant elements of the Solvency and Financial Condition Report to the amounts approved by the PRA in its letter to Lloyd's dated 18 December 2018.

### **Other Information**

We are not required to assure, nor have we assured and as a consequence do not express an opinion on the 'Other Information' which comprises:

- Information contained within the relevant elements of the Solvency and Financial Condition Report set out above which are, or derive from the Solvency Capital Requirement, as identified in Appendix 1 to this report;
- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report; and
- Lloyd's templates SO5.01.02, SO5.02.01, S.19.01.21 and S.25.03.21;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report ('the Responsibility Statement').

To the extent the information subject to assurance in the relevant elements of the Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

Lloyd's has authority to calculate its Solvency Capital Requirement using an internal model ('the Model') approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to assure the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.



Our assurance does not extend to information in respect of earlier periods or to any other information included in the Lloyd's Solvency and Financial Condition Report within which the relevant elements of the Solvency and Financial Condition Report as at 31 December 2018 are included.

In accordance with Rule 4.1 (3) of the External Audit Part of the PRA Rulebook for Solvency II firms we are required to read the Other Information (as defined above) and consider whether it is materially inconsistent with the relevant elements of the Solvency and Financial Condition Report and our knowledge obtained in the reasonable assurance engagement over the Solvency and Financial Condition Report and of Lloyd's pro forma financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

### **Our Independence and Quality Control**

We complied with the Institute of Chartered Accountants in England and Wales (ICAEW) Code of Ethics, which includes independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

We apply International Standard on Quality Control (UK) 1 and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

### **The responsibilities of the Council of Lloyd's and Our responsibilities**

The purpose of the Solvency and Financial Condition Report is to allow the Council of Lloyd's to report the solvency position of the association of underwriters known as Lloyd's in accordance with the requirements of Solvency II.

The Council of Lloyd's is responsible for the preparation of the Solvency and Financial Condition Report, including its basis of preparation, in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed below:

- Approval of items of ancillary own funds;
- Approval to use a partial internal model; and
- Modification of External Audit rule 4.1 for Lloyd's to obtain a reasonable assurance opinion in accordance with International Standard on Assurance Engagements 3000 (Revised) – 'Assurance Engagements other than Audits or Reviews of Historical Financial Information', issued by the International Auditing and Assurance Standards Board (IAASB).



The Council of Lloyd's is also responsible for designing and implementing an appropriate basis of preparation for this purpose and for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

Our responsibility is to express an opinion about whether the preparation of the relevant elements of the Solvency and Financial Condition Report has been performed by the Council of Lloyd's on the basis set out in Lloyd's basis of preparation.

**Intended users and purpose**

This report including our opinion has been prepared solely to the Council of Lloyd's in accordance with our engagement letter dated 6 December 2018 (the "instructions") to assist the Council of Lloyd's to comply with its obligations under External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose or to any other party save where expressly agreed by our prior consent in writing.

A handwritten signature in cursive script that reads 'PricewaterhouseCoopers LLP'.

**PricewaterhouseCoopers LLP**  
Chartered Accountants  
London  
16 April 2019



**Appendix 1 – relevant elements of the Solvency and Financial Condition Report that are not subject to reasonable assurance**

The relevant elements of the Solvency and Financial Condition Report that are not subject to reasonable assurance comprise:

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions - non-life (excluding health) - risk margin
  - Row R0590: Technical provisions - health (similar to non-life) - risk margin
  - Row R0640: Technical provisions - health (similar to life) - risk margin
  - Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
  - Row R0720: Technical provisions - Index-linked and unit-linked - risk margin
- The following elements of template S.12.01.02:
  - Row R0100: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0110 to R0130 – Amount of transitional measure on technical provisions
- The following elements of template S.17.01.02:
  - Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0290 to R0310 – Amount of transitional measure on technical provisions
- The following elements of template S.23.01.01
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds
- The following elements of Company template S.28.02.01:
  - Row R0310: SCR
- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.