Legacy Reinsurance Instructions

Instructions for completing legacy reinsurance transactions and supporting documentation

January 2023

Contents

1 Definitions

The following list contains definitions specific to legacy reinsurance transactions. For a more comprehensive list of acronyms please refer to the Lloyd's Capital Guidance.

Term	Description
Ceding Syndicate	A syndicate wishing to transfer legacy business exposures out of its portfolio.
Receiving Syndicate	A syndicate wishing to provide reinsurance (RI) for the legacy business exposures being offered by the ceding syndicate.
Legacy RI Transaction	The term 'transaction' refers to not only the formal Reinsurance to Close (RITC) deals, but also the other varying types of arrangement (e.g. Loss Portfolio Transfer (LPT), quota share, Adverse Development Cover (ADC) business transfers effected under part VII, etc).
Standard Lloyd's Capital Return (LCR)	The LCR submitted for the year of account excluding any legacy RI transaction activity.
Partial LCR	A reduced version of the LCR provided by the ceding syndicate which captures the standalone capital risk for the business being ceded. The Partial LCR contains only the 'key data' required to assess the transaction both by Lloyd's and the receiving syndicate.
Ongoing ceding LCR	The LCR the ceding syndicate would submit after a legacy RI business has been removed from the model. An estimated ongoing LCR is a provisional view of the ongoing LCR submitted to support the approval of a partial LCR.
Amended Standard LCR	A receiving syndicate's standard LCR, but including the additional capital requirement, plus reserve and claims data, relating to the inclusion of a legacy RI transaction.
Lloyd's Standard Model (LSM)	The Lloyd's standard model is the tool used to set capital for new syndicates, which do not have an internal model. Guidance for this process and the template can be found here: Requirements for new entrants.

2 Contact Details

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3 Purpose

This document provides instructions around the process for entering into legacy reinsurance transactions and gives details of supporting documentation required to take the transaction into account in terms of capital requirements. It also provides information in respect of the structure and timing of Lloyd's review.

This guidance relates to capital requirements only – syndicates need to engage with other teams at Lloyd's to discuss the wider requirements - in particular their account manager and the Lloyd's Legacy team.

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

4 General Principles

Whilst transactions often have some very specific features, some general principles are as follows.

- Any legacy RI transaction where the receiving party is a Lloyd's syndicate cannot be signed until the additional capital required to be held by the members on the receiving syndicate is lodged in Funds at Lloyd's (FAL).
- This means that receiving syndicates need to adjust their existing capital requirement to include the additional business.
- Lloyd's expect receiving syndicates to follow a thorough due diligence process and quantify the additional required. However, syndicates are unlikely to be able to model the new business fully in line with SII standards at that point in time. Hence syndicates will need to submit an LCR with a capital add-on to take the transaction into account, which needs to be reviewed and agreed by Lloyd's.
- Given the uncertainty of any capital add-on/management adjustment in the LCR Lloyd's requires the add-on to pass some minimum tests to gain comfort with the level of capital at market level.
- In order to facilitate the review of the capital add-on, ceding syndicates need to submit some additional data, i.e. a partial LCR to quantify the capital required for the business to be transferred. Additionally, for any transaction where a partial year of account is ceded, syndicates must also submit information about the account splits.
- Ceding syndicates can only release the capital after the deal has been signed and an updated LCR has been submitted and approved (in line with the MMC/QCT processes).

As an example, before a Loss Portfolio Transfer (LPT) is agreed, the ceding syndicate would be required to supply a partial LCR for the ceded business (to aid Lloyd's review) and the receiving syndicate submits an LCR with a capital add-on. The additional FAL must be in place from the receiving syndicate before the contract is signed. After the contract is signed both parties should submit an LCR taking the transaction into account in full in line with the regular QCT and major model change processes – the timing will depend on the materiality of the transaction and should be discussed with the syndicate's capital point of contact.

The same process is followed for all legacy RI transactions within Lloyd's.

5 Ceding Syndicates

The requirements for a syndicate wishing to transfer legacy business are set out in this section. Please note that this section only refers to transferring legacy business to another Lloyd's syndicate – for transfers outside of Lloyd's there are no additional requirements from a capital perspective – i.e. this can be allowed for in a syndicate's capital requirement in line with the standard LCR submission, QCT and major model change processes, however capital will only be released after the transaction has been finalised.

For transactions within Lloyd's the ceding syndicate is required to supply additional data to Lloyd's and Lloyd's will review and sign-off the transaction. Capital can only be released when the additional FAL has been lodged by the receiving syndicate and the deal has been signed.

Syndicates planning to transfer all years of account at the balance sheet date to another Lloyd's syndicate and become dormant will need to submit a partial LCR (rolled-forward to the balance sheet date to allow for up-to-date reserves etc.), but do then not need to submit an LCR, if the receiving syndicate includes the ceded business in its LCR submission. The syndicate must be prepared to submit a full LCR at short notice if the transaction is not signed before the Q4 QCT.

Where outwards reinsurance (ORI) had already been purchased by the ceding syndicate and still protects the exposures being proposed for legacy transfer, it must be clearly agreed between the ceding and receiving syndicates whether the rights and protections of these existing contracts will transfer together with the legacy business exposures, or if other actions are planned, for example commutation of cover prior to transfer. Review of outwards reinsurance contract terms will need to be carried out to ensure that this is permissible by the reinsurance counterparties and formal notification / endorsements made where necessary.

It is important that it is clear where the ultimate responsibilities and reinsurance credit risk lie in the event of any inuring outwards reinsurance failure or dispute, and this must be clearly worded in the legacy reinsurance contract.

It should be noted that, apart from RITCs, legacy reinsurance transactions are outwards reinsurance arrangements for the ceding syndicate and should be treated and reported as such in formal returns to Lloyd's, such as the Quarterly Monitoring Report Part A (QMA). Depending on the timing these may also need to be reported in the ceding syndicates Syndicate Reinsurance Structure (SRS) return. Please contact your Lloyd's ORI point of contact to discuss further.

As above, it is important that the legacy reinsurance contract is worded to clearly articulate where the ultimate responsibility and reinsurance credit risk lies in the event of any inuring outwards reinsurance failure or dispute.

5.1 Submission Requirements before the Transaction

Data Requirements

Before an arrangement can be entered, the ceding syndicate must submit a partial LCR (via the Market Data Collection (MDC) platform) for the standalone business being ceded in all circumstances, with one exception. The exception is where the RITC covers all years of account for a syndicate and the RITC takes place before the new modelling year of account – as the partial LCR would then be the same as the latest full LCR submission of the syndicate and is hence superfluous.

For partial year of account transactions (LPTs, split RITCs), the ceding syndicate must also provide a split of the Risk Codes to be ceded. Please contact your capital point of contact to arrange for the Lloyd's model risk code data to be provided to you, which must be split between risk remaining within the syndicate and being ceded. This is based on Lloyd's risk codes by year of account, split between currency USD/GBP level. Further detail will be supplied within the template when requested.

The partial LCR from a ceding syndicate contains the results of modelling the ceding business on a standalone basis and should exclude reinsurance that is not transferring to the receiving syndicate as part of the transaction. The ceding syndicate partial LCR should consist of the following forms and be submitted via MDC:

- Form 012 LCR Syndicate Type
- Form 309 LCR Summary (minimum ultimate basis, SCR1 can match uSCR or zero if unavailable)
- Form 310 Balance Sheet Distributions (minimum is Mean value and 99.5th will calculate)

- Form 311 Claims Distributions (minimum is Mean, 99.5th & the 99.8th can be placeholder to pass validations & full table 2 completion)
- Form 312 Projected Solvency II Technical Provisions at Time Zero
- Form 313 Financial Information (minimum is FX rate and Ultimate Net Mean values in table 3)
- Form 500 Premium Risk excluding Catastrophe – Quantitative Inputs (only required if the transaction includes unexpired risk.
- Form 510 Reserve Risk - Quantitative Inputs
- Form 530 Reinsurance - Quantitative Inputs (only required if reinsurance arrangements are transferring to the receiving syndicate)
- Plus, additional data on some of the other LCR forms required to pass errors (blocking submission) in the validations process in MDC.

The partial LCR data elements required are shown in a csv template which is available to download from the MDC LCR Return Help section called “PartialLCR_CSV_Instructions_202X”.

When creating a partial LCR return on MDC please ensure the hypothetical option is ticked on form 012 and link the return to the September submission date if submitting between September-December, the Q1 QCT submission deadline between January-February or the March submission date when submitting March-July.

The partial LCR must be reported in converted sterling. Submissions made prior to February must use the published prior 30th June rates, set out in Market Bulletin Y5376. Submissions made post February must use the 31 December rates.

The partial LCR submitted to Lloyd’s must be approved by the Board or an appropriately authorised committee, depending on the syndicate’s governance arrangements, and in line with the Governance, Risk Management and Reporting Principles (Principle 10) under the Principles.

Ceding syndicates are required to provide an e-mail confirmation to your capital point of contact that confirms you authorise Lloyd’s to discuss elements of your partial LCR with the receiving syndicate(s).

Ceding syndicates must inform Lloyd’s whether any existing reinsurance will be transferred together with the legacy transaction and advise where the associated reinsurance credit risk sits in the event of failure or dispute of insuring reinsurance to the legacy contract.

Submission Timings

The ceding syndicate must submit a partial LCR at the beginning of the process, ideally when the brokers are notified of a possible transaction. The ceding syndicate can only realise the benefit of a legacy reinsurance transaction in line with the timelines for the QCT process, as set out in section 5.5 of the Lloyd’s Capital Guidance. Lloyd’s will also only allow the benefit if the syndicate either triggers a major model change and/or the capital impact (including any preceding changes) is above 10% - as laid out in the guidance. Please note that the turn-around times for QCT submission are very short – and not necessarily sufficient review times for major model changes – hence syndicates should submit major model changes earlier. Please note that for a syndicate to take the benefit the deal also has to be signed – which means that the receiving syndicate will have to have submitted their capital add-on well in advance of the QCT deadlines. The following outlines the typical timelines:

- September – Notification of proposed transactions to Lloyd’s by ceding syndicates
- October/November – Submission of partial LCRs by ceding syndicates
- November/December – Receiving syndicate(s) provide updated LCRs reflecting the additional capital requirement – 4 weeks required to approve the transaction.
- December/January – Funds lodged in FAL ahead of the contract signing.
- January – Ceding syndicate submits a MMC (if necessary) and on-going standard LCR to reflect the reduction.
- February – Ceding syndicate resubmissions are approved, and new CPG agreement letters provided showing the agreed SCRs.

- Late February – Q1 QCT – Ceding & receiving syndicates go through Q1 QCT central adjustments based on Q4 rates and the Q4 QSR. Member capital test statements are released reflecting the Q1 QCT changes & FAL settlement requirements in March.
- March/April – Mid-Year CIL – Syndicate ECAs updated to reflect the mid-year central adjustments based on Q4 rates and the Annual Solvency Return (ASR) data. Member capital test statements are released reflecting the mid-year CIL changes & FAL settlement requirements in June.
- April – Updated CPG letters are provided to all agents reflecting the mid-year adjustments.
- May – Q2 QCT – Syndicate ECAs updated to reflect the Q2 QCT central adjustments, based on the Q1 rates and the Q1 QSR. Member capital test statements are released reflecting the Q2 QCT changes & asset settlements in June.
- June – Receiving syndicate submits MMC application (if required) to reflect the acquired business fully in the model and replace the capital add-on.
- July – Q3 QCT - Syndicate ECAs updated to reflect the Q3 QCT central adjustments, based on the Q2 rates and the Q2 QSR. Member capital test statements are released reflecting the Q3 QCT changes & asset settlements in September.

The final deadline for any deals for the current year of account is the Q3 QCT deadline (as set out in section 5.5 of the Lloyd's Capital Guidance); i.e. the partial LCR, the LCR with the add-on from the receiving syndicate and all other documentation needs to be submitted by the Q3 QCT deadline. Any MMCs by the ceding syndicate need to be submitted in line with the June MMC deadline and deals finalised before. If this cannot be achieved, the deal cannot be signed in August, whilst systems are being rolled over to the next year of account. In these cases please discuss with your point of contact – the partial LCR might have to then be submitted in line with the next full LCR submission in September/October and there might be a delay in the finalisation of the deal.

5.2 Requirements for the Ongoing LCR of the Ceding Syndicate

As mentioned above, if a syndicate is including all years of account in the RITC and is becoming dormant, then an LCR submission is not necessary, if the receiving syndicate is including the ceded business in their standard LCR submission for the new modelling year.

If the transaction does not fully close the syndicate, then the timing of the transaction will dictate the next standard LCR submission and also the timing of the release of capital.

If the ceding syndicate expects the transaction to be completed in the ongoing year of account and this is reasonably certain, then the standard submission in September/October can be submitted excluding the business being ceded, as for any other outward reinsurance transactions. The submission should include a full major model change application if this has been triggered according to the syndicate's model change policy. The syndicate should also submit a partial LCR for the ceded business at this point.

However, if the ongoing LCR is agreed by CPG prior to the contract being signed – then an adjustment (labelled as RITC Adjustment) will be included in the CPG letter for the benefit taken for the transaction as reported by the ceding syndicate. This adjustment can be removed when the following elements are all in place:

- the capital add-on has been submitted by the receiving syndicate and agreed by CPG
- the deal is finalised between the two syndicates
- the FAL has been lodged by the receiving syndicate
- the Lloyd's Legacy team have confirmed the contract can be signed
- the latest date all elements need to be in place is the first Thursday in November.

If the transaction is not reasonably certain before the submission in September/October and has hence not been included in the standard LCR submission, then the resubmission should be made in line with the QCT and major model change process. This means the syndicate should only resubmit if the transaction AND any prior changes made cause a capital movement of greater than 10% (measured before impact of risk margin, foreign exchange and Reinsurance Contract Boundary). Otherwise, the current standard LCR will remain in place. Any resubmission must adhere to the Lloyd's Capital Guidance. Resubmissions made in January should use the June foreign exchange rate and bridge from the Q4 QCT supplied LCRs (where appropriate).

In the absence of an LCR resubmission post transaction, for prior year RITCs only, Lloyd's will amend the current ceding syndicate LCR data to reflect the movement in reserves only, the Economic Capital Assessment (ECA) will remain the same. This removes the risk of misallocation of the ECA to the closed years of account in the internal model and member modelling software.

6 Receiving Syndicates

Any legacy RI transaction where the receiving party is a Lloyd's syndicate cannot be signed until Lloyd's have approved an amended standard LCR incorporating the transaction and the additional capital required by the members on the receiving syndicate is lodged in Funds at Lloyd's (FAL). Receiving syndicates with an approved capital model must model the impact of the transaction and provide the resulting additional capital requirement in the form of a management adjustment to Lloyd's for assessment. The adjustment can be determined by running the additional business through the existing model – but potentially with some simplification, where detailed information is not available in time to carry out class parameterisations etc. If this is not possible, the adjustment can be derived in other simplified ways outside of the capital model. In any case syndicates should clearly allow for the uncertainty around the capital required given the lack of information. In the section below there are details of minimum tests Lloyd's will apply to the capital add-on.

Please note that where the receiving syndicate is planning to purchase additional outwards reinsurance for the incoming business, the benefit can be taken into account for capital requirement, subject to approval by Lloyd's ORI team and also the 'Outwards Reinsurance Allowance' reduction detailed below. Early engagement with the ORI team is essential in order that the risk transfer is understood; additional details of the proposed reinsurance may be required depending on the expected scale by way of a 'Legacy Questionnaire' which will be provided by Lloyd's to the receiving syndicate. The Lloyd's ORI team should also be notified of the intention regarding any in-force outwards reinsurance and whether this will transfer with the legacy transaction, and where the ultimate responsibility and reinsurance credit risk lies in the event of any inuring outwards reinsurance failure or dispute.

The capital add-on will then stay in place until the syndicate has submitted a major model change (and this has been approved). The MMC submission should be made as soon as possible, but generally would be no later than the third Thursday in June for transactions effective from the previous year-end or 6 months after the effective date of the transaction. When planning the timing of the MMC submission, the agent should carefully consider how long it will take to understand, parameterise and fully validate the modelling of the legacy business and how this integrates with existing business within the internal model. The MMC should be made in accordance with the Model Change Guidance. Similarly, if no major model change is triggered according to the receiving syndicate's major model change policy, then the transaction should be included as a minor model change as part of the next regular submission. The timing of any major model changes should be agreed with the capital point of contact in advance. Failure to meet the timetable for integration of the legacy RI transaction into the internal model is likely to raise governance concerns, which may have an impact on Lloyd's appetite for the syndicate to enter further legacy RI transactions.

6.1 Requirements for the Temporary Capital Add-on

Each legacy RI transaction should be modelled in the receiving syndicates approved internal model, and submitted individually for review, i.e. any validation/justification should just explain the transaction being added per amended standard LCR submission. If a second transaction is agreed, this should be submitted as if the first transaction has been included in the model, therefore allowing for diversification between transactions. When providing the documentation for review of a further transaction, the new transaction data should be reviewed individually to the original business (including the initial transaction), which will aid assessment of the transaction under review.

Data Requirements

If you are successful in negotiating the transaction, an updated LCR submission is required via MDC. The new additional capital requirement should be included in the amended LCR submission via the management adjustment on form 309, plus adding the combined (transaction(s) plus original data) claims/reserves information on forms 311 & 312. The LCR should not have the hypothetical option ticked as it will be used to set capital.

The updated LCR must include the following:

- Form 309 - The additional capital requirement modelled must be entered into the management adjustment cell for both the ultimate and one-year SCRs.
- Form 311 – The additional claims data must be included in table 2 and table 1 where necessary.
- Form 312 – the additional technical provision data must be included.
- Form 313 – the additional exposure must be included in table 3.

The documentation accompanying the updated LCR is not expected to be as comprehensive as for a standard LCR submission, as the additional capital requirement is only in place temporarily. However, syndicates are required to submit the following in addition to the forms above (as attachments to the LCR or via SecureShare):

- A mock form 309 showing a comparison of post diversified risk types pre and post transaction (form 309 on MDC will only show the original business).
- A comparison of the total net reserves pre and post transaction vs the ceded partial LCR (can be based on form 312).
- A comparison of net reserves by year of account and class before and after the transaction. Additionally, information should be provided on the volatility and correlation assumptions used.
- Justification of the adequacy of the total additional capital requirement. This needs to include documentation around how the capital requirement has been calculated (methodology), any assumptions made and simplifications carried out (e.g. proxy classes or temporary parameters used). In particular the syndicate should outline how the uncertainty around the transaction has been taken into account given that this is new business to the syndicate and data might not be available at this point.
- Independent validation – this should be proportionate but at the very least checks should be carried out that the calculation has worked as intended and is correct as well as validation of any material assumptions made, including potential alternatives. Validators should also sense check the adjustment and ensure it is in line with expectations.
- Information on the level of any outwards RI included, including the impact and a justification of the credit risk allowance.
- Justification of the operational risk allowance, in particular with regards to potential anti-selection risk, risks around the failure of the due diligence process and risk around staffing with regards to the new business. The submission should be clear around the arrangements in practice (e.g. if claims handling will be transferred to the receiving syndicate or stay with the ceding syndicate etc.).
- Justification of the market risk allowance. In particular, the syndicate should be clear if assets are transferred and what the investment strategy is.
- If, in exceptional circumstance the minimum tests set out below are not met, then justification must be provided for any failures for Lloyd's consideration.

Minimum Tests

Lloyd's will apply the following minimum tests with regards to the capital add-on. Please note that the minimum tests will be carried out for each transaction in turn.

The minimum tests are individually reviewed by Lloyd's and so if a receiving syndicate failed multiple tests, the expectation is that each test will be remedied or justified individually. However, a syndicate (or Lloyd's) should not duplicate loadings. For example, an operational risk loading being applied in line with the minimum operational risk test below will have an impact on the uSCR to net reserves ratio – which means that the loading can remedy two test failures.

Syndicates should increase their additional capital requirement in order for the minimum tests to pass. If that is not the case a loading might be applied by Lloyd's.

- **Operational Risk:** The minimum operational risk amount included in the receiving syndicate additional capital requirement should be more than 10% of the 'modelled' additional capital requirement value (post diversification). For example, if the additional capital requirement modelled for the ceded business is £45m, but operational risk only contributes £3m, then an additional op risk load of £1.2m is required (I.e. £45m - £3m then * 10% = operational risk of £4.2m). Then the additional capital requirement included in the LCR, as a management adjustment, is £46.2m added to the previous agreed uSCR for the syndicate. This will also be subject to a minimum absolute amount of £500k.
- **Diversification Credit:** The additional capital requirement provided for any transaction must be a minimum of 20% of the ceded syndicate calculated standalone uSCR as submitted in the partial LCR. This means Lloyd's will apply the following test:

  Total new SCR = max(SCR before transaction + 20% ceded standalone SCR, submitted SCR plus capital add-on).

If the receiving syndicate's original uSCR is lower than the ceded uSCR then the threshold test reverses, so that the additional capital requirement provided for the transaction must be a minimum of 20% of the receiving syndicate uSCR (which would then be added to the ceding syndicate uSCR to establish the full uSCR requirement). This means Lloyd's will then apply the following test:

Total new SCR = max(20% of SCR before transaction + ceded standalone SCR, submitted SCR plus capital add-on).

This is just for the illustration of the threshold test the LCR submission would be based on the original syndicate uSCR plus the additional capital requirement modelled.

For example, if the original syndicate uSCR is £100m and the additional standalone capital requirement for the ceded business is £50m – then the minimum required uSCR is £110m = 100+20%*50. However, if the reverse is true (i.e. the original uSCR is £50m and the additional standalone capital requirement is £100) then the minimum required uSCR is still £110m – and not £70m=50+20%*100.

- **uSCR to net Reserves Ratio:** The additional capital requirement as a percentage of ceded net reserves should be greater than 30%. The ceding syndicate net reserves for the purposes of Lloyd's review will be sourced from form 312 of the partial LCR of the ceding syndicate and calculated as: Ceded Net Reserves = Total Column H + Total Column I – Total Column J.
- **Outwards Reinsurance Allowance:** Where additional outwards reinsurance for the legacy transaction is to be purchased by the receiving syndicate to reduce the additional capital requirement, details of the reinsurance must be discussed and agreed in advance with the Lloyd's ORI team. The modelling is expected to include a minimum of 10% reduction of the reinsurance benefit to allow for concentration risk which must be evident in the calculation of the additional capital requirement.
- **Contributions to Capital:** Contributions from all risk types to the additional capital requirement should be positive.

Lloyd's Review Process

Lloyd's review will follow the process set out for general LCR reviews set out in LCR Instructions. Given the relatively short timeframe the review will focus on the minimum tests and the justification of the additional capital requirement. The review will be limited to the syndicate capital team and, if necessary, the outwards reinsurance team – reserving tests of uncertainty will not be carried out and reviewed. The reviewer might ask clarifying questions throughout the review, although these will be kept to a minimum due to the short turnaround time. Results of the review will be presented to and discussed at the Actuarial Oversight Review Group (AORG). Any proposed loadings will be sent to the Capital team at the syndicate. Account Managers will also communicate potential loadings to the executive of the syndicate.

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

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

Loadings are of an indicative nature and are designed to address the uncertainty surrounding the capital numbers if certain questions cannot be resolved satisfactorily. Responses from syndicates will be reviewed before a recommendation is presented to the Capital Planning Group (CPG).

A recommendation regarding the syndicate's capital will then be presented to CPG. The CPGs decision will be communicated by Account Managers verbally and followed up with a letter shortly after the panel meeting. CPG decisions can be appealed; syndicates should contact their Account Managers regarding procedures.

Note that depending on the materiality of the transaction, approval of a capital requirement (that doesn't require a loading) may be delegated to AORG, not requiring CPG review.

Member Level Capital Requirements

Following agreement of the additional capital requirement by Lloyd's, the syndicate will then be expected to hold sufficient member FAL to fund the full increase in the member ECA resulting from the transaction. The FAL increase must be funded prior to the transaction being signed, unless sufficient FAL surplus is in place.

As an example, the calculation for a syndicate with an ECA of £300m with an additional capital requirement (incl. economic capital uplift) of £100m and a single corporate member with no additional diversification would be: If the member held FAL of £290m before the transaction (given that FAL funding can be as low as 90% of the ECA level), then the additional capital to be lodged would be £100m (as not QCT FAL funding will be applied to the additional requirement). However, if the member held FAL of £305m before the transaction, then only £95m of additional capital would need to be lodged.

The restrictions on tier 2 assets (letters of credit, bank guarantees) must also be considered in accordance with Market Bulletin Y5177. The additional capital requirement will then be subject to the normal central adjustments made by Lloyd's for the ongoing QCT and mid-year CIL processes (foreign exchange rates, change in risk margin, reserve margin and Reinsurance Contract Boundary (RICB), plus any other MRC review loadings and adjustments that may be required).

6.2 Treatment of Outwards Reinsurance

Existing Outwards Reinsurance

Where outwards reinsurance had already been purchased by the ceding syndicate and still protects the exposures being proposed for legacy transfer, it must be clear and agreed between the ceding and receiving syndicates whether the rights and protections of these existing contracts will transfer together with the legacy business exposures, or if other actions are planned, for example commutation of cover prior to transfer. Review of outwards reinsurance contract terms will need to be carried out to ensure that this is permissible by the reinsurance counterparties and formal notification / endorsements made where necessary.

It is important that it is clear where the ultimate responsibilities and reinsurance credit risk lie in the event of any inuring outwards reinsurance failure or dispute, and this must be clearly worded in the legacy reinsurance contract.

Lloyd's should also be notified of the intentions regarding the existing ORI as part of the legacy communications and the capital impacts incorporated (where appropriate) into the partial LCR supplied to Lloyd's.

Additional Outwards Reinsurance

Any additional ORI arrangements being considered for a legacy RI transaction by the receiving syndicate must be discussed and agreed in advance with the Lloyd's ORI team.

It should be noted that the general concentration risk guidance applies (but applies to the transaction on a standalone basis, not to the whole portfolio of the syndicates), i.e. a 10% reduction in the reinsurance benefit for concentration risk is applied.

Notification

- Receiving syndicates must engage with the Lloyd's ORI team at the earliest opportunity where they plan to buy additional reinsurance and take credit towards additional capital requirement.
- The additional ORI arrangement must meet the Lloyd's Supplemental Requirements and Guidelines.
- The receiving syndicate must have adequate procedures and controls to reflect the materiality of any inherited and any additional outwards reinsurance as per the Lloyd's Reinsurance Principles of Doing Business
- There will be an expectation to provide details and proof of any stop loss / ADC / QS percentage benefit at the start of the review process (for an ADC though we would need the agent to be well advanced in that process, as there is less comfort on those contracts.)
- Where the magnitude of the additional outwards reinsurance and the proposed capital credit to be taken is deemed to be material, Lloyd's ORI team may require additional information by way of a 'Legacy Questionnaire' which will be provided by Lloyd's to the receiving syndicate;

Ratings & Concentration Risk

- Receiving syndicates must provide details of the intended ORI reinsurer(s) and confirm that they at least hold a Financial Strength Rating (FSR) of A- or equivalent rating from a recognised credit assessment or rating institution. If the FSR is below A- the exposure must be 100% collateralised to at least the 1:200 estimated exposure. Even where collateral applied, the 10% minimum concentration risk must still be allowed for in the modelling.

- There may be circumstances where additional collateral / funding is required to mitigate risks, for example, excessive financial dependency on reinsurance counterparties and / or concentration risk. These would be considered on a case-by-case basis by the ORI team as presented and as required by the Supplemental Requirement & Guidelines. It should be noted that if there is perceived to be a heightened potential for reinsurance risk, other actions may be taken in addition to ensure that the level of risk is managed / mitigated, and these are set out in the Supplemental Requirements & Guidelines.
- Syndicates should adequately allow for uncertainty in the modelling. This should provide Lloyd's with further comfort that the capital is appropriate as an interim capital setting solution.

The Legacy Reinsurance Contract Itself

It should be noted that, apart from RITCs, legacy reinsurance transactions are outwards reinsurance arrangements for the ceding syndicate and should be treated and reported as such in formal returns to Lloyd's, such as the Quarterly Monitoring Report Part A (QMA). Depending on the timing these may also need to be reported in the ceding syndicates Syndicate Reinsurance Structure (SRS) return. Please contact your Lloyd's ORI point of contact to discuss further.

As above, it is important that the legacy reinsurance contract is worded to clearly articulate where the ultimate responsibility and reinsurance credit risk lies in the event of any inuring outwards reinsurance failure or dispute.

6.3 Requirements for the Ongoing LCR of the Receiving Syndicate

The LCR submission with the capital add-on will be subject to the same adjustments in the QCT as for any other LCR submission. The capital add-on will then stay in place until the syndicate has submitted a major model change (and this has been approved), which is generally over the summer or in the next modelling year. Similarly, if no major model change is triggered according to the receiving syndicate's major model change policy, then the transaction should be included as a minor model change as part of the next regular submission. The timing of any major model changes should be agreed with the capital point of contact in advance, in particular as Lloyd's is looking to minimise the number of applications received from RITC syndicates in any year.

6.4 Modelling considerations for the receiving syndicate

When first making a capital submission to Lloyd's post signing a deal, whether the change constitutes a minor or major model change, there are some modelling aspects the syndicate should consider. Generally, legacy syndicates monitor the deals separately – which means that the new deal might be added as new classes of business. Syndicates should consider the principle of homogeneity and volume – classes should be large enough to ensure sufficient data and information is available to parameterise them but should be homogenous enough for the risks to behave similarly. In particular, syndicates should ensure that splitting classes by deal does not result in correlations between classes being understated.

- You should provide details of the parameterisation of the classes that are new to the syndicate. If that relies on expert judgement, you should ensure justification is provided for the expert judgement, in line with the .
- You should provide details of the correlation assumptions between the new and existing classes, along with justification and validation of those assumptions.
- When reviewing the correlation assumptions between new and existing classes Lloyd's will pay particular attention to classes that write similar business. For example, a General Liability class from the new book of business vs a General Liability class in the existing book. Lloyd's will expect a high level of correlation between such classes, or very robust justification for why that isn't required.

Moreover, given that the risk profile is in general less varied for legacy syndicates (given that capital is mainly driven by long-tailed casualty risks) syndicates should ensure that systemic drivers like latent claims and claims inflation are modelled appropriately.

Additionally, syndicates should consider any operational risks specific to legacy reinsurers, like e.g. the risk of failures in the due diligence process.

6.5 Requirements for other capital related submissions to Lloyd's

Syndicates are required to submit the standard formula to Lloyd's in November. The standard formula submission should include any capital add-ons in place at that time – i.e. exposures should be included in the standard formula calculation and the standard formula should be in line with the LCR submission in September/October. Additionally, syndicates are required to submit the internal model outputs (IMO) returns to Lloyd’s in March. Lloyd’s advises syndicates to include the capital add-on for any legacy transactions as part of “other risks” in their IMO return.

7 New Legacy RI Providers

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

7.1 Capital Setting for the Current Modelling Year

The Lloyd's Standard Model (LSM), which is generally used to set capital for new syndicates, is currently not appropriate for use by syndicates writing legacy reinsurance who do not have an internal model, as the prior year reserves are modelled in bulk in the current version, which is unlikely to appropriately reflect the risk profile.

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

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

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

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

7.3 Capital Setting First Transaction

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

7.4 Capital Setting for Additional Transaction(s)

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

7.5 Treatment of Additional ORI Arrangements

Any additional ORI arrangements being considered for a legacy RI transaction by the receiving syndicate must be discussed and agreed in advance with the Lloyd's ORI team.

It should be noted that, to give Lloyd's additional comfort in the capital levels, a 10% reduction in the allowance is applied in addition to the minimum 10% reduction for concentration risk (outlined in the treatment of outwards RI section), providing prudence to allow for credit risk of the financial instruments, dispute risk and uncertainty in the modelling.

As an example, an 80% quota share arrangement would yield a 64% reduction in the capital requirement set under this interim approach. Once the syndicate submits the transaction as part of the capital model the general concentration risk guidance will apply which is contained within the Lloyd's Capital Guidance.

7.6 Treatment of Risk Margin in the Quarterly Solvency Return (QSR)

As the syndicate does not have an internal model and capital is set based on the syndicate benchmark model, the risk margin will also be set by the SBM and provided to the syndicate by Lloyd's. Syndicates should include this risk margin in their QSR and Annual Solvency Return (ASR) submissions to ensure consistency in the capital stack.