Reserving Tests of Uncertainty:
2024 Business Planning and Capital Approval

January 2024

Reliance and Limitations

Content contained within is wholly for discussion purposes only

References

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

Purpose & Scope

The purpose of the information contained within is for discussion on changes/updates to the Reserving Tests of Uncertainty performed as part of YE Capital Approval. The scope of this is limited to changes/updates to testing from the 2023 YE Capital Approval process to the 2024 YE Approval process.

Reliance and Limitations

The information contained within is an overall summary of changes. Lloyd’s will send Syndicate specific communication where indicated in the pack in respect of the 2024 Reserving Tests of Uncertainty.

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

This publication supersedes any previous packs supplied by Lloyd’s (including drafts and for discussion only documents) in respect of the 2024 Reserving Tests of Uncertainty.

Contents

Introduction and purpose

The purpose of this pack is to provide market participants with details on the Reserving tests of Uncertainty framework for the 2024 capital and business planning approval process along with key dates.

The Reserving tests of Uncertainty were introduced in 2019 to assess key areas, from a reserving perspective, that are inputs to the capital model and could lead to under capitalisation if inappropriate. The expectation is that these inputs are appropriate in respect of adequately reflecting uncertainty. The Lloyd’s testing framework primarily used data from returns readily available to Lloyd’s to flag Syndicates for oversight and (where required) capital loadings were applied to address deficiencies identified by the testing.

Since 2019 there has been year on year reduction in the number of Lloyd’s loadings applied to Syndicates in respect of these tests as syndicates approach reflects Lloyd’s guidance. In direct response to this market improvement, the testing framework for the 2024 capital and business planning approval process has been reassessed and updated.

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

Reserving Tests of Uncertainty: 2024 Coming Into Line Capital Setting

High level framework for each Reserving Test of Uncertainty

Test	2024 Testing Framework	Key Dates
Prospective year Modelled Loss Ratio	• **Actual versus Plan testing will not be conducted for the 2024 YE Capital Approval process** • Recent history indicates syndicates have appropriate model loss ratio assumptions as the number of Lloyd’s loadings for inappropriate model loss ratio assumptions has reduced. • **We will continue to retrospectively apply capital loads to syndicates that have a trend of missing their capitalised loss ratio on a normalised basis at Mid-Year Capital Approval** • **We will continue to perform Minimum Tests related to modelled loss ratios** (Modelled Loss Ratio Floor Test and the Decrease In Self-Uplift test)**.**	• LCR 561 & Focus Area return tests in relation to the minimum tests continued as in previous years during Capital and Planning Approval process
TP Roll Forward	• **No changes vs 2023 YE Capital Approval testing framework** • No market-wide testing (in line with previous year) • Individual syndicates monitored using simple metrics from data already available • Back testing template required for flagged syndicates only	• Syndicates selected for completion of back testing template notified via email during June 2023
Solvency Tests	• **No changes vs 2023 YE Capital Approval testing framework** • Testing for Mid-Year Capital Approval only, based on YE SAO and Q4 ASR	• March 2024 next testing
Best Estimate Review	• **No changes vs 2023 YE Capital Approval testing framework** • Specific agents notified due to ongoing concerns including any material deficiencies against the Reserving Principle. • Agents expected to demonstrate, via evidence, material progress against highlighted concerns to alleviate loading requirement • Any loading amount based on expert judgement and discussions with agent	• Syndicates selected for review notified via email including next steps during July 2023

Prospective year Modelled Loss Ratio: Minimum Tests & Retrospective Loss Ratio Test

Details of Testing Framework for 2024 Capital and Business Planning Approval process

Modelled Loss Ratio Minimum Tests

We will continue to perform these tests via the Focus Area Questionnaire.

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

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

Modelled Loss Ratio Floor guidance

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

Plan to Modelled Self-Uplift

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

How will we perform these tests

- Both tests will be required to be reported upon within the Focus Area (FA) Questionnaire
- Syndicates will be required to submit their Plan and Modelled LR along with any additional rationale where they have failed these tests.
- Lloyd’s will consider syndicate rationale as part of the LCR review and query further if necessary.
- Insufficient justification may result in a Capital Loading.

Retrospective Modelled Loss Ratio Appropriateness test

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

Identification of syndicates who fail the test

There has been one key update to the testing framework compared to the prior year.

- Previously, the test flagged syndicates if:
  - The latest YOA actual net loss ratio (normalised for cats) exceeded the capitalised net loss ratio (i.e. SBF loss ratio plus modelled self-uplift) by more than 2%ppt
  - At least 2 out of 4 years prior YOAs had an actual net loss ratio (normalised for cats) which exceeded the capitalised net loss ratio by more than 2%ppt (though it should be noted we only started collecting the adjustments made to the plan loss ratios for capital modelling from the 2020 YOA, hence the comparison for 2019 and prior YOAs is against plan net loss ratio)

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

2024 Capital process

- Lloyd's will perform this test based upon the data submitted to us as part of your QMB, SBF and LCR returns for the 2019 - 2023 YOAs.
- Lloyd's will run this test indicatively using 2023 Q3 data and will notify syndicates that are currently triggering a loading under this assessment at the time.
- The full assessment will be undertaken using 2023 Q4 data and all Syndicates triggering a loading will be informed w/c 26th February 2024
- Syndicates will be informed on whether further capital is required via the CPG process.

Further details of the testing framework will be provided during 2023 Q4 via the Actuarial Oversight Quarterly Update email communication.

Technical Provisions Roll Forward

Details of Testing Framework for 2024 Capital and Business Planning Approval process

Technical Provisions Roll Forward test updates

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

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

- Projected Q4 TPs (LCR 312) compared to Actual Q4 TPs (ASR 002 / 210) over the past 3 year-end submissions
- Consideration of both:
  average understatement over 3 year period (2020-2022)
  and
  number of year-ends where projection of Q4 TPs was understated
- Technical provisions considered including catastrophes
- Legal obligations excluded, risk margin included, undiscounted basis

Selected syndicates will be informed by Lloyd's via email during June 2023

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

- ***Submission of back-testing template required by 31 July 2023***
- Back-testing template and loading calculation will remain the same as prior year
- In particular, back-testing template will concentrate on non-cat
- "Self-loading" is not permitted; either a Lloyd's loading will be applied or the expectation is that a Syndicate would update the roll forward process to eliminate historical deficiencies

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

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

Appendix

1. Key Timelines by Test

2. Key differences between 2023 and 2024 testing framework

Timeline for interaction with the market

Expected interaction between Lloyd's and the market for the 2024 Reserving tests

	June	Jul	Aug	Sep	Oct	Nov	Dec-Feb	Mar
Prospective Year Loss Ratio				Prospective Year Loss Ratio reviews from LCR 561 and Focus Area submissions				
Retrospective Loss Ratio Test						Market-wide testing using Q3 QMB data to notify Syndicates of potential loads	Market-wide testing (Retrospective Loss Ratio Test) using Q4 QMB data. Syndicate's may receive a controls load	
Technical Provisions Roll Forward	*During June* Syndicates selected for review informed, back-testing template released	Back- testing template submission	Review of back-testing template and communication of outcome to Syndicates					
Solvency Tests								Testing based on Q4 2023 ASR
Best Estimate Reviews		*During July* Syndicates selected informed	Main period for review completion	Conclusion of review and communication of outcome to Syndicates				

Recap of 2023 testing and 2024 updates

High level framework for each Reserving Test of Uncertainty

Test	2023 Testing Framework	2024 Testing Framework
Prospective year Modelled Loss Ratio	• **No market-wide Actual versus Plan testing** • Individual syndicates monitored using simple metrics from data already available • For syndicates flagged through this process, review of prospective year modelled loss ratio methodology and assumptions for key classes • High risk Syndicates reviewed in July/August, prior to YE Capital Approval • Low risk Syndicates considered for review within Annual Reserve Meetings • Continued testing on LCR Form 561 & Focus Area return for the Modelled Loss Ratio Floor and change in self uplift	• **No Actual versus Plan testing at all** • Continued testing on LCR Form 561 & Focus Areas return for the Modelled Loss Ratio Floor and decrease in self uplift • **We will continue to retrospectively apply capital loads to syndicates that have a trend of missing their capitalised loss ratio on a normalised basis at Mid-Year Capital Approval via the Retrospective Loss Ratio test**
TP Roll Forward	• No market-wide testing • Individual syndicates monitored using simple metrics from data already available • Back testing template required for flagged syndicates only	• **No changes**
Solvency Tests	• Testing for Mid-Year Capital Approval only, based on YE SAO and Q4 ASR	• **No changes**
Best Estimate Review	• Specific agents notified due to ongoing concerns • Agents expected to demonstrate, via evidence, material progress against highlighted concerns to alleviate loading requirement • Any loading amount based on expert judgement and discussions with agent	• **No changes**

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