LLOYD'S

New Syndicate Capital Guidance

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Contact Details

For both technical and general queries please contact your capital point of contact or email SCR.Returns@lloyds.com.

Contents

1 Purpose

The purpose of this document is to set out the capital setting process for new entrants and syndicates moving from one managing agent to another. In particular, this outlines the process for:

- the initial approval of the new entrant by Lloyd's from a capital perspective as part of the "Making it Happen" process
- the process to obtain approval to set capital using the syndicate's own internal model
- demonstrating compliance with Lloyd's 'Principles for Doing Business' Principle 7.

This document is intended to be read in conjunction with the main capital guidance document and the 'Principles for Doing Business' at Lloyd's ("The Principles").

2 Overview of the Process

New entrants go through the "Making it Happen" process once the Lloyd's Council has given an agreement "in principle" to the application to set up a new syndicate or managing agent. More information on the wider Making it Happen process can be found here.

In general, this requires new entrants to show that they are fulfilling The Principles. However, the capital principle requires a Solvency II compliant internal model, which needs longer timeframes and significant resource to build. Therefore, new syndicates will set capital using Lloyd's' Syndicate Benchmark Model (SBM) until they have had their internal model approved and are compliant with Principle 7 of The Principles.

Syndicates are required to have applied for and been granted internal model approval within 3 years of account of underwriting. For Syndicates in a Box (SIAB), this is extended to 4 years so that the internal model application can be made after approval has been given for the SIAB to transfer to full syndicate status. Syndicates cannot normally apply for internal model approval within less than one year of account since the evolving nature of the risk profile of new syndicates usually means frequent major model change ("MMC") submissions are required to ensure the internal model continues to reflect the syndicate's risk profile.

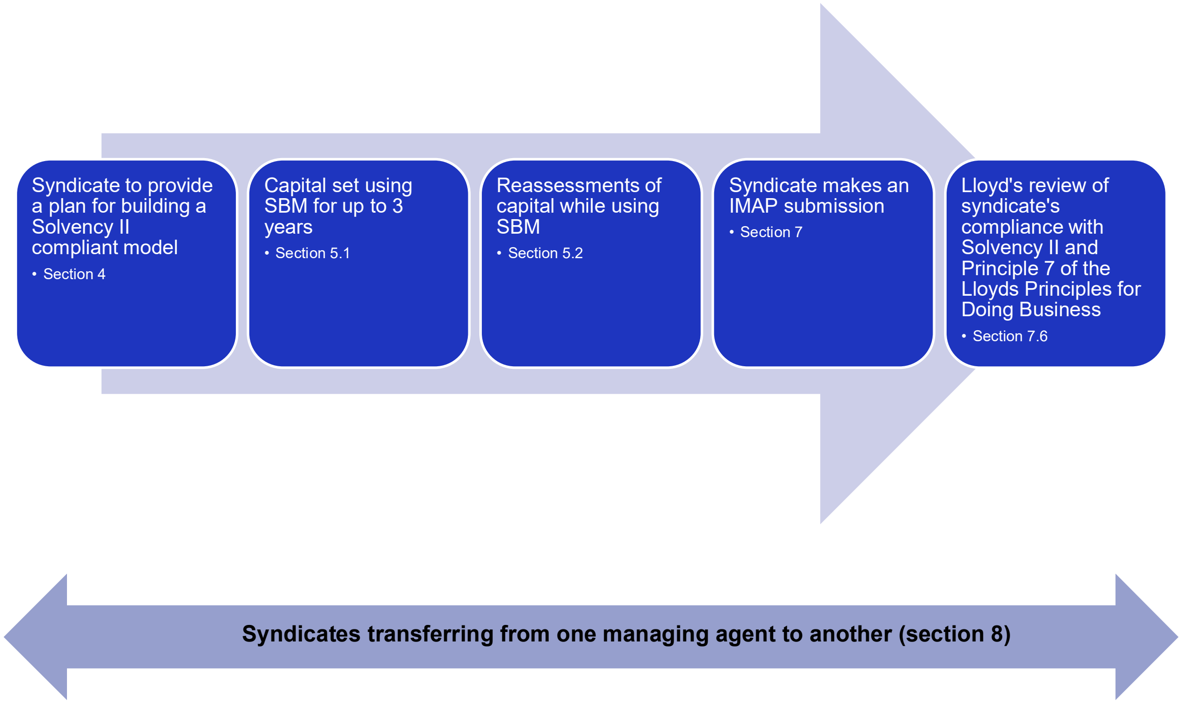
The timeframes set out below mean that syndicates setting capital using their own internal model in their second year of account effectively have to apply for model approval relatively shortly after starting to write business and syndicates should discuss timings as early as possible with Lloyd's.

More information about the SBM and the processes for communicating SBM capital requirements to syndicates is set out in section 5.

Section 7 outlines the process for new syndicates to obtain internal model approval.

For syndicates transferring from one managing agent to another a review similar to the 'Making it Happen' review for new entrants will be conducted to consider whether the syndicate continues to meet expectations with regard to The Principles. Section 8 sets out the internal model considerations specific to such syndicates.

The diagram below gives an overview of the process for setting capital for new syndicates.



3 Lloyd's 'Principles for Doing Business' for New Syndicates

The main capital-related principle in The Principles is Principle 7 'Capital' which outlines the following:

1. Maintain an internal model which captures all material risks that the syndicate is exposed to.
2. Use modelling assumptions which are realistic and justifiable, methodology which is adequate, and all material limitations are understood.
3. Have strong feedback loops joining the business and the model.
4. Demonstrate robust governance and understanding of the model. This includes adequate understanding and challenge at senior management level.
5. Implement changes to the model which are reasonable and justified and their impact on the SCR adequately explained.
6. Conduct objective challenge of the internal model through independent validation.

When a syndicate begins operating, it will be given an Overall Rating of "New" for The Principles, with no rating assigned for Principle 7 while capital is set on the SBM. This is a temporary status and is equivalent to a neutral rating.

4 Plan for Compliance with Solvency II and Principle 7

As part of the Making it Happen process, managing agents will be required to submit a plan to Lloyd's setting out how they will achieve compliance with Solvency II and Principle 7 of The Principles (see section 7.6 of this document for how that is assessed at the time of the IMAP submission). Lloyd's will review that plan and will work with the syndicate to ensure it is reasonable.

The plan should cover areas such as:

- When the syndicate plans to set capital using its own internal model for the first time and when it plans to submit the internal model application to Lloyd's.
- The planned resource for the capital and validation teams, covering areas such as the expected number of people in the team, the level of experience and a hiring plan. The syndicate should also set out contingency

plans if hiring takes longer than expected and resource is not available according to the initial plan. Any agreements or discussions with consultancies should also be outlined.

- The capital modelling platform, cat risk vendor model and economic scenario generator (ESG) vendor model the syndicate intends to use and why. It should outline how market risk/catastrophe risk are going to be modelled if no external vendor models are planned to be licenced. This should also include if any software has been licenced already or when licences are expected to be in place.

- The data systems that will be in place.

- Outline the planned governance of the capital model, in particular which committees will be responsible for signing off capital and major model changes, and the make-up of those committees. This should also include a high-level timeline of when policies affecting the internal model are expected to be adopted and approved.

- The plans for internal model validation (e.g. using external or internal validators and resourcing around this), in particular setting out how the syndicate will ensure that the validation is independent, any challenges and contingency plans.

- The feedback loops planned to be in place between the capital model team and validators, governance, and the business.

5 Syndicate Benchmark Model (SBM)

The Syndicate Benchmark Model calculates the capital requirement using information provided by the syndicate in its Syndicate Business Forecast (SBF) and the Lloyd's Catastrophe Model (LCM) forecast return. Note that the SBM does not include hypothecated reserves and so, all other things being equal, the capital requirement will increase each year as an additional year of reserves is included in the capital calculation.

The SBM uses market level volatilities, adjusted to reflect the size of the syndicate's exposure. No further adjustments are made to the SBM to reflect the individual syndicate's exposures and Lloyd's is unable to accommodate requests to adjust the SBM for factors such as syndicate specific rate changes (although it should be noted that market-level rates changes are reflected).

The SBM, including the market level volatilities it uses, is updated once a year between May and August. Syndicate data input to the SBM is updated when the syndicate resubmits the SBF or LCM.

5.1 Setting capital using the SBM

The capital number from the SBM is calculated after data inputs (such as the SBF and LCM) have been provided to Lloyd's.

An indicative number can be provided after all data is received, but this will not have been reviewed by CPG and therefore is an indication only. It can take up to 4 weeks after all data is received to provide the indicative number, but Lloyd's aims to provide this significantly quicker. Note that an indicative number will not be provided if the SBF is being actively challenged by Lloyd's.

The Member Modeller team is responsible for calculating the capital requirement so any questions on the process should be directed to them. The capital requirement will be communicated to syndicates via their account manager.

Once the capital number has been agreed by CPG, the agreed capital number will be communicated via the CPG letter. This is usually done within 2 working days of the CPG meeting taking place.

5.2 Updates to Capital After the Initial Agreed Capital Amount

The SBM is usually only updated when the syndicate submits either an SBF or an LCM. However, in line with all other syndicates in the market, some adjustments are made as part of the Quarterly Corridor Tests (QCT) and Coming Into Line (CIL) processes. These are:

- June CIL and Q2 QCT – update to the year-end USD exchange rate and the latest RICB adjustment from the ASR/QSR;

- Q1 and Q3 QCT – update to the latest quarter end USD exchange rate and the latest RICB adjustment from the QSR.

Since the 10% threshold for syndicates to update their capital is applied before adjustments for foreign exchange and RICB movements, there would be no reason for the movement in capital to breach that threshold without an SBF or LCM re-submission.

See the Capital Guidance (section 5.5) for more detail on the wider QCT process.

While a syndicate has capital set using the SBM, the risk margin will also be calculated by the SBM and provided to the syndicate by Lloyd's. This risk margin needs to be used in the Pillar 3 reporting (ASR/QSR) by the syndicate and the capital setting process (by Lloyd's) consistently. The risk margin will only be provided once a year, one week in advance of the Q3 QSR submission deadline, and is to be used for all the subsequent QSR and ASR submissions unless Lloyd's issues a revised risk margin.

5.3 Business Planning Using the SBM

Lloyd's recognises that knowledge of the capital implications of specific strategies will assist planning, therefore where possible Lloyd's will provide additional SBM model runs, e.g. to test the impact of an indicative SBF or growth plans.

6 New Syndicate Load

A new syndicate load of 20% is applied to new syndicates. The Syndicate Capability Oversight (SCO) team assesses the operational risks and capabilities associated with new syndicates and the decision on the new syndicate load is made by CPG (Capital and Planning Group). New syndicates should discuss this area with their account managers.

7 Internal Model Approval Process (IMAP)

Syndicates will need to go through an internal model approval process before they are permitted to begin setting capital using their internal model. The IMAP will involve a draft LCR submission review, a model walkthrough, a validation review, a Solvency II compliance review and an assessment of the syndicate against the expected maturity for Principle 7 of The Principles.

7.1 Timings

Syndicates should start the internal model approval process in the year before they plan to use their model for capital setting. Syndicates can only set capital using the internal model for the first time during a September/October capital submission, not a March resubmission.

The internal model approval process should start with a draft LCR submission **no later than 31 March** prior to the first anticipated use of the internal model for capital setting purposes. So, if a syndicate aims to set capital on their internal model for the first time in September 2022 (for the 2023 year of account), a draft submission of the LCR should be made by 31 March 2022. Syndicates should contact the capital point of contact to discuss the exact timings.

Syndicates should be mindful that the further in advance of their first full submission an IMAP is submitted, the more time they will have to address any resulting Lloyd's feedback – however, the submission should be of a quality that is suitable for Lloyd's to review.

7.2 Initial Completeness Checks

Lloyd's will carry out initial completeness checks to highlight to the managing agent early on if the submission does not meet Lloyd's requirements. The result of the initial completeness checks will be communicated within 10 working days of the draft LCR submission.

7.3 Draft Submission

The draft submission should be of sufficient quality to allow a full and detailed review by Lloyd's. Syndicates will be required to provide all documents listed in the Submission Requirements section of the LCR Instructions (section 2), except the Analysis of Change and Model Change Template.

Lloyd's will undertake a detailed review of these documents in order to confirm that the model is in line with Lloyd's guidance and calculates an appropriate capital requirement for the syndicate. Feedback will be provided to syndicates 10 weeks after a complete IMAP submission is made to Lloyd's, to allow time for any material feedback that could result in loadings to be addressed prior to the September submission.

In addition to the key metrics set out within Form 600, Lloyd's review will focus on a number of areas, including but not limited to:

- All risk types are expected to make a meaningful contribution to capital. If this is not the case, the syndicate should carefully explain the justification for this.
- Syndicates should pay particular attention to the contribution of operational risk as Lloyd's considers this to be a key risk for new syndicates.
- Lloyd's will require detailed information on the parametrisation process and outputs for key classes, including the data relied on, where the syndicate does not have a history of writing such business.
- The dependency structure and level of dependency – both within risk types and between different risk categories. Syndicates should pay particular attention to the tail dependencies.

Syndicates should also refer to the Capital Guidance (section 9.3.11) for guidance related to modelling new classes of business, as the principles there are likely to be relevant here.

Other requirements for internal model approval include:

- Model walkthrough – In the model walkthrough Lloyd's will step through examples of how model processes are applied in practice (e.g. parameterisation for a class of business and / or areas of the dependency structure). Lloyd's will assess the example areas against the sub-principles that underpin the capital dimension of the 'The Principles'. This would include, for example, a look at use of data and methods, selection of assumptions, limitations, expert judgments, capital team resourcing, application of governance policies and the validation process.
- Syndicates will be required to complete a template to provide syndicate-specific modelling information (the SSI Template), which can be found on Lloyds.com.
- Solvency II compliance assessment/Principle 7 of 'The Principles' review (see section 7.6).

7.4 Model Walkthrough Process

The examples chosen for the walkthrough will be based on material model/risk profile areas such as the dependency structure and/or parameterisation of key classes of business.

To this end, a detailed agenda will be sent to managing agents by week three of the review for a walkthrough to happen by week six. This gives Lloyd's time to have an initial review of the draft submission and identify the most useful areas to step through with managing agent staff. The detailed agenda will highlight the specific example areas to be covered and any features of these areas that Lloyd's may wish to discuss in detail (e.g. for a model area example Lloyd's may choose to focus on treatment of data while for another there may be a focus on assumption setting and the governance process).

By the end of week four Lloyd's will share queries with the agent that should also be covered in the model walkthrough. These queries will be based on review that has happened to that point and would be appropriate to cover in person with the agent. At the same time Lloyd's may make other final updates to the detailed agenda.

The walkthrough should happen by week six in the form of a two to three hour in-person (or virtual) meeting between Lloyd's and managing agent staff. After the walkthrough Lloyd's will summarise the meeting and draw conclusions to be presented and discussed at the Actuarial Oversight Review Group ("AORG"), which is the committee that will approve IMAPs, unless escalation to CPG is required. This may indicate areas to investigate further in the IMAP, or for feedback and review in the future.

7.5 Validation

At the time of the draft submission, syndicates are required to submit full model validation. Please see the Validation Guidance for information on what should be considered in the validation process and report, including development of a targeted plan for performing tests in line with a 3-year validation cycle. A full validation in this context means carrying out the full scope of the validation of the internal model and not just the calculation kernel. The Validation Guidance (section 2.7) has mode detail on what is included in the scope of full validation.

A validation report should be submitted illustrating that validation has been carried out in line with 'The Principles' and Validation Guidance. The 3-year validation cycle does not need apply to the first validation report submission because, as previously mentioned, all areas of the model should be validated for the draft submission. For areas where the syndicate has applied a simplification and is planning further refinement, the validation process should assess that capital reflects the uncertainty around the simplification adequately and include a summary of this work in the report.

It is appreciated that syndicates may not be able to apply certain tests or validation tools by the time of the draft submission, due to lack of underwriting experience or otherwise.

- Validators will not be able to complete an analysis of change or review how the model strength has changed over time for the draft submission. However, this testing should be provided with the first official LCR submission to compare against the draft LCR submission.

- Where a syndicate is in its first or second underwriting year, there may be limitations in the extent of testing against experience that can be performed. In this case syndicates should consider any relevant internal and external data that could be used for backtesting and extend the usual range of testing that is applied to the affected model areas.

- Syndicates will not have prepared a Profit and Loss (P&L) Attribution Report by the time of the draft LCR submission if they had not parameterised the model for the prior underwriting year, therefore we do not require syndicates to provide one with either the draft submission or the first official LCR submission. However, syndicates must submit this report by 1 April in the year after the first official LCR submission. For example, a syndicate that makes an official submission for the 2023 year of account, a P&L attribution should be submitted by 1 April 2024, comparing the actual 2023 P&L versus the P&L forecast in the 2023 model. The submission to Lloyd's should include the report itself and a summary of the review carried out by the validation team, if the validation team did not produce the original analyses.

Given a full validation report is expected to be provided for the IMAP, it is not expected that this is repeated for the first full submission. As it states in the validation guidance, the onus is on the validator to ensure that any appropriate updates are made and tests are re-run if necessary. The validation report for the first full submission should include appropriate information to demonstrate that validation applied to earlier versions of the model remains sufficient to validate the current model and provide bridges between versions where appropriate.

7.6 Compliance with Solvency II and Lloyd's 'Principles for Doing Business'

Based on the detailed information reviewed as part of the IMAP review, Lloyd's will assess the syndicate against their expected maturity for Principle 7 of The Principles.

Compliance with Solvency II will also be reviewed and Syndicates are required to submit additional documents for this part of the review - the list of required documents is included in Appendix 1 of this Guidance.

All of the items in that list should be submitted to Lloyd's by 31 March in the year the syndicate would like to use their own internal model for capital setting for the first time – i.e. if the syndicate intends to set capital using their own model for the first time for the 2023 year of account, then all items in that list should be provided by 31 March 2022.

7.7 Conclusion of the IMAP

Following completion of the IMAP a conclusion will be reached by the AORG. This conclusion along with more detailed feedback will be sent to capital contacts by the Lloyd's capital point of contact.

8 Syndicates transferring Managing Agents

When syndicates transfer from one managing agent to another, Lloyd's will need to confirm that the new managing agent continues to set capital in a Lloyd's approved and Solvency II compliant internal model. The process will vary depending on whether the new managing agent will continue to use the internal model used by the previous managing agent or if the syndicate will be using a new internal model. It is possible for the syndicate's capital to be set temporarily by the SBM during the transition, i.e. while a new model is built if required. Timeframes and transitions will be assessed on a case by case basis with the managing agents.

8.1 Syndicates Switching to Using a New Internal Model

When a syndicate changes to using a new internal model, they will be required to provide a plan for compliance with the Solvency II and Principle 7 of The Principles (as outlined in section 4) and go through the full IMAP process (as outlined in section 7). This requirement applies whether the syndicate will be using a newly built model or a model that already exists (and has been approved by Lloyd's) at the new managing agent.

While the syndicate is seeking internal model approval, their capital will be set on the Syndicate Benchmark Model. All timings for getting internal model approval are as per the new syndicate guidance outlined in section 2 and section 7.

8.2 Syndicates Continuing to Use the Existing Internal Model

When syndicates continue to use the previously approved internal model after they have transferred to the new managing agent, they will be able to follow a partial-IMAP process, rather than the full IMAP process (outlined in section 7). It is noted that the syndicate and new managing agent are required to arrange agreement with the previous managing agent to continue using the same internal model – which means they will need visibility of the inputs and the modelling code.

Since the syndicate is continuing to use the same internal model, any feedback (capital, validation or other) given to the syndicate under the previous managing agent will continue to apply and will be required to be addressed. If a change in process means that the prior feedback points are no longer relevant the syndicate should make that clear and justify why that is the case.

As this situation involves the use of an internal model that has already been approved by Lloyd's, the partial-IMAP will focus on ensuring the capital team at the new managing agent has the required skills to use the internal model appropriately and that suitable governance processes are in place.

The steps of the full IMAP process that are also required for the partial-IMAP process are as follows:

- Model walkthrough – in line with the model walkthrough outlined in section 7.4, the model walkthrough will be used to consider examples against each of the sub-principles that underpin Principle 7 of The Principles. This would include, for example, a look at use of data and methods; selection of assumptions; limitations; expert judgments; capital team resourcing; application of governance policies; and the validation process.

- Confirm compliance with Solvency II and Principle 7 of The Principles, as outlined in section 7.6

- Detailed Validation review – this will be carried out after the 1st LCR submission that the syndicate submits. Syndicates will be required to submit a full signposting template to aid this review. The full signposting template may differ from that published on Lloyds.com and will be provided by Lloyd's as required. The versions differ following feedback from the market on the increasing reporting requirements for regular submissions.

9 Requirements for First Full Submission

Once a syndicate has their internal model approved, they should use this for subsequent capital setting submissions. The requirements for this are set out in the Capital Guidance and LCR instructions in force at that time. This includes the requirement to submit a Model Change Template (MCT) and Analysis of Change, covering changes and movements between the draft and full submission.

It is not expected that a full validation report is repeated for the first full submission. As it states in the validation guidance, the onus is on the validator to ensure that any appropriate updates are made and tests are re-run if necessary. The validation report for the first full submission should include appropriate information to demonstrate that validation applied to earlier versions of the model remains sufficient to validate the current model and provide bridges between versions where appropriate.

10 Appendix 1: Documents Required for the review of compliance with Solvency II and Principle 7 of The Principles

In order to demonstrate compliance with Solvency II and to aid the assessment of performance against expected maturity for Principle 7 of The Principles, syndicates are required to provide a number of documents as outlined below. These should be submitted to the capital point of contact via SecureShare.

In addition to the documents listed below, once the syndicate capital team has assessed the syndicate's expected maturity for Principle 7 based on the draft LCR submission, the syndicate will be provided with a self-assessment template. The syndicate is then required to complete a self-assessment for Principle 7 of The Principles. More information about the self-assessment can be found on Lloyds.com.

The list of documents required to be provided at the same time as the draft LCR is as follows:

- Board pack and minutes for the sign-off of the draft LCR submission (for full IMAPs)
- Responsibilities Map
- Fit & Proper Policy (or confirmation by the Chair of the Board that there is an up-to-date policy in place)
- Remuneration Policy (or confirmation by the Chair of the Board that there is an up-to-date policy in place)
- Business Continuity Policy (or confirmation by the Chair of the Board that there is an up-to-date policy in place)
- Any evidence of prior reviews that the syndicate conducted to assess SII compliance (if applicable)
- Risk Management Policy
- Risk Register (updated)
- ORSA report
- Model Change Policy
- Model Use Policy
- Documentation policy
- Any evidence that demonstrates how the Board and Senior Management understand the model uses or just confirmation by the Chair that the Board and Senior Management are comfortable with the model uses
- Any documentation around how the internal model is integrated in the risk management system (if not already within the Model Change Policy)
- Internal Model Scope Policy (or this might be part of an overarching Internal Model Policy)
- Expert Judgement Log
- Any SCR Methodology or parameterisation documents not already sent previously with LCR submissions that provide relevant information on the appropriateness of methodology or assumptions.
- Documentation explaining how techniques, methods and assumptions used in the model are considered to be adequate, up-to-date, and generally accepted market practice (if not already covered in other documents requested)
- Documentation addressing how future management actions are considered to be reflected appropriately in the internal model
- Internal Model Data Policy / Data Directory
- Internal Model Validation Policy
- Model governance structure
- Internal audit report on data quality
- Standardised syndicate information template
- Records of internal model training for Board members and other key personnel involved in model governance
- Approved risk appetites