

Market Bulletin

Ref: Y5113

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| Title | Economic Capital Assessment (ECA) Process for 2018 Underwriting Year of Account |
| Purpose | To set out the ECA process for the 2018 underwriting year, including basis of calculation, and arrangements for distribution of the Member Modelling Software ('Member Modeller') |
| Type | Scheduled |
| From | Neil Wells, Manager Member Capital, Market Reserving and Capital Finance +44 (0)20 7327 6034 neil.wells@lloyds.com |
| Date | 10 August 2017 |
| Deadline | See timetable at Appendix 1 for LCR and SBF submission dates 25 August 2017 – First 2018 release of Member Modelling Software 5 September 2017 – Webinar Presentation |
| Related links | SCR Guidance Update 2018 ECA Guidance Manual |

Introduction

Please note that the structure of this annual Market Bulletin relating to the ECA process has been changed in order to better relay key messages for the year ahead. Recurring, but nonetheless important, instructions have been moved to an evergreen designated area of Lloyds.com. Readers of this Bulletin should ensure that they are familiar with those fundamental process points set out in the ECA Guidance manual linked above.

This Bulletin confirms the key process points to note for setting and modelling member capital for the 2018 underwriting year, during calendar years 2017/18. In addition, a summarised business timetable and details of key modelling improvements are provided in the appendices.

Key Points to Note:

- *The first formal SBF and LCR submissions are due in September, in respect of Group 1 syndicates, preceded by a High Level Plan (HLP) submitted in July.*
- *Initial indicative Member Modeller release in August based on rolled forward 2017 data, scaled to reflect proposed changes in aggregate premiums (from HLP).*
- *Developments to the Member Modeller since last year are outlined in Appendix 2. The key developments are the inclusion of run-off years of account for life syndicates and an augmented 'Publish' function to enhance the year-end audit process.*
- *Syndicates are being asked to provide year of account splits of their solvency capital requirement to ultimate (uSCR) via the Supplementary Questionnaire in order for Lloyd's to validate the reasonableness of the split inferred from the central model.*
- *Confirmation that the 40% minimum capital requirement now applies to all members.*
- *Confirmation that the 35% uplift will continue to be applied to the uSCR to derive members' ECA.*
- *From 2018 full year coming into line, in November next year, there will be a phased introduction of a limit on the proportion of Tier 2 capital allowed by member within FAL. Further details on the implementation of these measures will be provided during Q4 2017.*
- *All active members share of future syndicate solvency deficits are to be fully covered by Tier 1 capital, with immediate effect, with a transitional period to the 2018 full year coming into line deadline.*

SCR Submission Requirements

The uSCR and the one-year Solvency Capital Requirement (SCR1) must be submitted via the Lloyd's Capital Return (LCR) by 1pm on the stipulated dates for Group 1 and 2 syndicates respectively. The categorisation of Group 1 and 2 syndicates is set out in market bulletin Y5083. Requirements for managing agents to submit the LCR pro-forma, an analysis of change document, the Supplementary Questionnaire and a methodology document for 2018 have been set out in the SCR instructions on Lloyds.com (see link in title of this Market bulletin):

As part of the Supplementary Questionnaire this year, syndicates are being asked to provide year of account splits of their SCR requirement in order for Lloyd's to validate the reasonableness of the split inferred from the central model and ensure fairness in allocating capital to members. Where significant disparity is identified this will be investigated and an adjustment may be made where appropriate.

Managing agents applying for approval of 'Major Model Changes', at any time during the year, should contact their MRC Analyst and provide the appropriate documentation to

enable an assessment of the changes. Managing agents are required, in any case, to submit a year on year analysis of change in their SCR. Managing agents are also required to submit a full validation report in support of their SCRs.

All relevant dates and details are set out in the timetable at Appendix 1

Syndicate Business Plan Submissions (SBF)

SBF submission deadlines are also set out in the timetable and vary between Group 1 and 2 syndicates. The final LCR submission must be based on the final SBF submission. Although the requirement for a full July SBF submission has been removed, managing agents have submitted HLP data and this will be used to estimate the rollover position, which will be reflected in the August Member Modeller release.

The Capital Setting Process for the 2018 Year of Account

The ECA Member Modelling Software ('Member Modeller') will be made available to registered users from 25 August. The Member Modeller will be updated in accordance with the business capital timetable, reflecting SBF and uSCR submissions, Capacity Auctions and Coming into Line (CIL) deadlines. See Appendix 1 for further details.

Exchange Rates

All LCR submissions should be based on 30 June 2017 SBF exchange rates. Resubmissions of the LCR, made in March 2018, should be based 31 December 2017 year end rates of exchange. Movement in exchange rates will be kept under review and Lloyd's will consult and advise of any proposed action due to material changes.

Year End Adjustments

Syndicates are required to keep under review the business plan and uSCR agreed for year-end CIL. If circumstances change, leading to a material change in SBF and/or uSCR, by the end of February 2018, then a resubmission of relevant returns must be made by 01 March 2018. Further details are included in the ECA Guidance manual on Lloyds.com.

Reinsurance Contract Boundary adjustments

All agents are now required to model the Outward Reinsurance Contract Boundary adjustment (RICB) within their internal model.

Lloyd's Internal Model Parameter Changes

Lloyd's parameters have been reviewed and updated based on historic data as usual. There has been particular focus on ensuring that unnaturally open syndicate years of account are allocated an appropriate share of the overall capital requirement.

Economic Capital Uplift (ECU)

Lloyd's will continue to apply an uplift to the minimum regulatory capital requirements to derive ECAs at member level. The uplift of 35% has been subject to normal annual review by the Franchise Board, taking into account current circumstances, and is reconfirmed for 2018.

Introduction of Tier 2 Capital Limit in Members' FAL

Solvency II tiering test has introduced a restriction on the amount of Tier 2 capital (at member level: letters of credit, bank guarantees and life policies) eligible for solvency coverage. At 31 December 2016 Tier 2 capital in members' FAL generated a solvency disallowance of £1.9bn and resulted in the Lloyd's market wide solvency ratio being diminished. We need to manage the Lloyd's market wide solvency ratio over time whilst continuing to allow members the flexibility to use Tier 2 capital as FAL.

To achieve these objectives we will introduce a limit on the proportion of members' FAL allowed in the form of Tier 2 capital for 2018 full year coming into line, with further reductions for 2019 and 2020 full year coming into line. Each member's Tier 2 capital allowance will be limited to 90% of ECA from November 2018, reducing to 80% for 2019 and 75% for 2020.

In addition this change provides a greater degree of flexibility around the provision of capital in the aftermath of a market turning event. Further details on the implementation of these measures will be provided during Q4 2017. During the transition period, requests to increase the proportion of Tier 2 capital within a member's FAL will be subject to approval by Lloyd's to ensure an orderly transition. This notification and the guidance to follow supersede the guidance on Lloyd's policy of rationing the availability of LOCs or Ancillary Own Funds in Market Bulletin Y4984.

Coverage of Solvency Deficits

With immediate effect, all active members share of syndicate solvency deficits are to be fully covered by Tier 1 capital. This requirement will be phased in as follows:

(i) solvency deficits incurred from 1 July 2017 to 31 December 2017 are to be fully covered by Tier 1 capital by the 2018 mid-year coming into line deadline, currently timetabled for 30 June 2018.

(ii) solvency deficits incurred prior to 1 July 2017 are to be fully covered by Tier 1 capital by the 2018 full year coming into line deadline, currently timetabled for 1 December 2018.

All solvency deficits incurred from 1 January 2018 are to be covered by Tier 1 capital by the full and mid-year coming into line deadlines accordingly, by reference to the amounts reported in the respective capital/release test statements. Changes to solvency position prior to capital/release test statements being issued will be considered in the next assessment period. i.e. if a solvency deficit is reported at 31 December and this improves before the issue of the capital/release test statement in April, the improvement will be factored into assessment for the period to 30 June.

Member Modeller

Use of the Member Modeller

All requirements and registration forms for prospective new users are set out in the ECA Guidance manual. Existing users will not need to do anything unless you are an agent that changes its name or authorising Director.

New Developments

All new changes for this year are detailed in Appendix 2, the two most significant relating to run-off life syndicates and the 'Publish' process. The calculation for life members was not previously designed to incorporate run-off years of account, but this has now been rectified. The publish function has also been developed to make it more robust and integrated to our year-end audit process. All Members' agents will be asked, when publishing their final member underwriting and capital requirements, to confirm that this is indeed the final CIL position. This will be recorded as a new "Published Participation Set", which cannot be changed, and will form the starting point of our year-end audit. Members' agents will not be able to change members' participations and 're-publish' without first seeking specific permission from Lloyd's, at which point permission may be granted to submit a revised version. Agents are requested to publish their CIL results by no later than 20 December.

Life member conversions

Members' agents are reminded that when calculating the Unlimited Back Year Liabilities (ULBY) for a donor life member, that this will always be equal to the donor member's ECA requirement and this should be used when calculating the amount of FAL that can be made interavailable to the successor member.

Training and Support

An e-mail help mailbox will be in operation to deal with queries on the ECA process and software, and for other ECA related questions. Agents with a Market Mail connection should access "Lloyds-MRC-Help"; the full e-mail address is: Lloyds-MRC-Help@lloyds.com

There will be a Webinar presentation on 5 September, demonstrating Member Modeller changes for this year and giving users the opportunity to raise any questions on the use of the software.

Meeting Details:

Meeting number (access code): 840 638 013

Password: MM2018

If you would like further details and reminders please notify us of your interest to Lloyds-MRC-Help@lloyds.com

If you require any more information regarding the capital setting process and Member Modeller, please contact one of the following:

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Economic Capital Assessment Timetable

| Deadline | Topic | Activity |
|------------------------|-----------|---|
| 25-Aug-17 ⁱ | ECA | Provisional Member Modelling Software release, which includes indicative rollover information only . |
| 31-Aug-17 ⁱ | ECA | Member Modeller (CY version) updated for 30th June 2017 exchange rates for use in September Release Test |
| 06-Sep-17 (1pm) | SBF | Managing agents to submit final 2018 SBFs for Group 1 ⁱⁱ syndicates, via core market returns website. |
| 13-Sep-17 (1pm) | LCR | Managing Agents to submit final LCR pro forma for Group 1 syndicates, based on the final 2018 SBF submission. The LCR submission should include full documentation on parameterisation and methodology, plus the supplementary questionnaire. |
| 15-Sep-17 | LCR | Group 1 syndicates to send Analysis of Change documentation via SCRReturns@lloyds.com if not included with the LCR on the 13 September. |
| 22-Sep-17 | LCR | Group 1 syndicate to send Validation report via SCRReturns@lloyds.com if not included with the LCR on the 13 September. |
| 29-Sep-17 | ECA | Indicative Member Modelling Software update based on final submitted 2018 YOA Lloyd's Capital Return (LCR) and Syndicate Business Forecast (SBF) of ALL syndicates. |
| 02-Oct-17 (1pm) | SBF & LCR | Managing Agents to submit final SBF & LCR pro forma for Group 2 syndicates. The LCR submission should include full documentation on parameterisation and methodology, plus the supplementary questionnaire. |
| 05-Oct-17 | LCR | Group 2 syndicates to send Analysis of change documentation via SCRReturns@lloyds.com if not included with the LCR on the 02 October. |
| 09-Oct-17 | LCR | Validation report to be sent via SCRReturns@lloyds.com if not included with the LCR on the 02 October. |
| 20-Oct-17 | SBF | SBF approval deadline for non-aligned syndicates. |
| 25-Oct-17 | ECA | Pre-Auction Member Modelling Software update, based on agreed SCR's for syndicates involved in the auction process |
| 31-Oct-17 | Auction 1 | Day one of Lloyd's capacity auction: number one. |
| 07-Nov-17 | Auction 2 | Day one of Lloyd's capacity auction: number two. |
| 03-Nov-17 ⁱ | ECA | Member Modelling Software update based on latest agreed SCR's for aligned syndicates only (no changes made to non-aligned data without prior approval). |
| 10-Nov-17 | Capital | Deadline for all Members to submit Bank Guarantee, Letters of Credit or Life Policy applications/instructions, partial releases and substitutions. |
| 14-Nov-17 | Auction 3 | Day one of Lloyd's capacity auction: number three. |
| 20-Nov-17 | SBF | SBF approval deadline for aligned syndicates. |
| 23-Nov-17 ⁱ | ECA | Member Modelling Software update based on agreed SCR's for the December CIL exercise. |
| 01-Dec-17 | CIL | Deadline for active members to ensure they are in line with capital funding requirements. |
| 20-Dec-17 | CIL | Members' Agent to 'Publish' their CIL results in the Member Modeller |
| 01-Mar-18 ⁱ | LCR | Managing Agents to re-submit an LCR pro-forma where there has been material change to syndicate ultimate SCR from that agreed for December CIL. Any resubmission should be based on year-end exchange rate and latest QMC risk margin. |

NOTES:

ⁱ Denotes provisional dates that may be subject to change. So this document should only be used as a guide. Please refer to Lloyd's.com for the latest information and full business timetable:

<http://www.lloyds.com/the-market/business-timetable>

ⁱⁱ Group 1 & Group 2 syndicates are defined in the market bulletin Y5083

Software updates

We have made a few improvements to the Member Modelling software. Below we have listed those which represent the more significant changes to functionality and usability:

| Subject | Description |
|---|---|
| Manage Group Participations | Currently, Group Participation Sets cannot be exported from the Manage Group Participation Sets page. This functionality has now been added to the 'action' dropdown. |
| Life Members filtering on View Members page | Currently, users are unable to filter the list of Members on the View Members page by Life Members. An additional option to filter by Life Members in the filtering option has now been added. |
| Multiple view member selection | Currently, the selection of multiple view members involves applying a filter relevant to the grouping and then selecting checkboxes individually if a subset of members is required. To improve ease of use, it will now be possible to select multiple checkboxes using the 'shift' key. |
| Publish process | The publish functionality has been enhanced to improve auditability. A new published set is created at the point of publish. This set is created from the active set, but is then fixed. Subsequent changes to the active set are possible, but separate. In the unlikely event that a Members' agent needs to make a change to the published results, it needs to contact Lloyd's MRC to arrange this. |
| Dummy Members page | Vertical Scrolling has been incorporated on the Dummy Members page together with the adding of alphanumeric pagination, as is present on the View Members page. The pagination functionality will allow users to filter the member list alphanumerically. |
| Life ECA calculation: Run-off years | Currently, the Life ECA calculation only considers the last three open years. The proposed change will now include run-off years in the Life ECA calculation. |
| Creating Dummy Members | Currently, an Agent can create or import a Dummy Member regardless of whether the Dummy Member number belongs to another Agent, resulting in duplicated Dummy Member numbers. Going forward, Agents will be prevented from creating or importing Dummy Members if the member number exists for a real member. The Agent will be prompted via the banner message to request access via the Share Member functionality. |