

FROM: Head, Market Risk and Reserving Unit EXTN: 5235
DATE: 24 August 2005 REF: Y3616
SUBJECT: **ECONOMIC CAPITAL ASSESSMENT (ECA) DERIVATION FOR
SYNDICATES AND MEMBERS**

SUBJECT AREA(S): Individual Capital Assessment (ICA), Risk Based Capital (RBC)

ATTACHMENTS:

ACTION POINTS: **For information only for managing agents, members agents, direct
corporate members and other members who use the ECA software**

DEADLINE(S): **None**

Introduction

For the 2006 underwriting year of account Lloyd's is introducing a new capital setting process, which is to be known as Economic Capital Assessment (ECA). This will replace the Risk Based Capital process.

This bulletin describes the ECA process for the 2006 underwriting year. It adds to and repeats some of the information given in the Market Bulletin Y3565 accompanying the May release (dated 20 May 2005). Please refer to this May Bulletin for further background.

Economic Capital Uplift

As stated in bulletin Y3565 approved syndicate ICAs will be uplifted by an economic capital margin to ensure Lloyd's overall aggregate capital is maintained at a level necessary to retain its desired credit rating. Accordingly ICAs for the 2006 Year of Account will be uplifted by an economic capital margin of 35% (i.e. the ICA will be multiplied by 1.35). This uplift will be applied to all ICAs. For the 2006 year of account only, all uplifted ICAs will be subject to the transitional arrangements as detailed below.

Transitional Arrangements

For the 2006 year of account exercise only, it has been agreed, following consultation with the market, that movements in syndicate level capital, as ultimately determined using ECA software,¹ should be capped when compared to the old market average based approach. This will be achieved by imposing a 15% 'corridor'. That is to say that when modelling final business plans, any movement in the syndicate capital requirement due to the inclusion of the ICA adjustment and economic capital loading, up or down, will be limited to 15% of capital under the old RBC basis².

¹ Including ICA adjustment and economic capital loading

² i.e. indicative syndicate capital ratios as produced by 2006 software before any adjustment to reflect ICAs

Examples:

	1	2	3	4
Syndicate agreed ICA + economic capital loading	48%	50%	60%	74%
Syndicate capital under old market average basis	60%	55%	45%	45%
Corridor	51% - 69%	46.75% - 63.25%	38.25% - 51.75%	38.25%-51.75%
Syndicate capital requirement	51%	50%	51.75%	55%

As an additional constraint, the syndicate-level capital must be at least as high as the syndicate ICA itself. In the above example 4, assuming the syndicate ICA before economic capital loading was 55%, then 55% would represent the syndicate capital requirement, because the final syndicate capital can be no lower than the ICA submitted.

The corridor will be assessed relative to the market average syndicate capital corresponding with the latest, or ultimately the approved, business plan of the syndicate. It is stressed that it is a moving comparison and not based on the capital requirement at a fixed point in time (except for coming into line, CIL).

Member level capital requirements are determined using syndicate economic capital after applying the corridor, but it should be recognised that member capital can be impacted by other factors (e.g. the capital ratio of a member participating on a single spread syndicate can deviate from the syndicate ratio due to varying its participation share across years of account). It is emphasised that the corridor does not apply directly to the member capital requirement. For aligned single syndicate members there will be a direct mirroring of the syndicate corridor, but for spread members the effect cannot necessarily be predicted exactly without the use of the member software.

Interpretation at Member Level

Within the ECA software, each syndicate economic capital requirement will be realised by multiplying the syndicate capital under the old market average basis (RBC) by a multiplier (either a loading or discount) to ensure it equals the ICA plus economic capital post-corridor. The multiplier input into the ECA software is to 4 decimal places, so the final pound amount of the ECA may differ slightly from the ICA inclusive of the 35% economic margin.

At Lloyd's, it is members which ultimately are capitalised and not syndicates. Within the ECA software a member will receive a member level multiplier based upon the syndicates upon which it participates. A member which participates on one syndicate only will receive the multiplier equal to that applied to the syndicate. Where members participate on more than one syndicate they will receive a 'weighted' factor based upon:

- the participation of the member on each syndicate;
- the syndicate capital under the old market average basis.
- the syndicate multipliers

Further details can be obtained from the Market Risk and Reserving Unit.

August Software Release

The software release on 24th August 2005 will include the ECA multiplier for all signed off syndicate ICAs **only**.

In general the software will include a multiplier for all non-aligned syndicates, or in a few cases no loading will be applied where the ICA is not fully resolved.

For aligned syndicates which do not have a signed off ICA, agents can still provisionally model member capital requirements based on their 'anticipated ECA requirement'. The process for this is as follows:

1. Given the 'anticipated ECA requirement', £X, (= final ICA x 1.35)
2. Output the syndicate capital requirement from the software, £Y,
3. Calculate the multiplier = X / Y, (subject to corridor provisions)
4. Input the multiplier into the software on the 'Syndicate Business Plans' page, in the field marked 'Loading Multiplier',
5. Save the software,
6. Open the 'Member Participations' page, and proceed as usual.

Managing agents will also have access via the market returns website to RTF (rich-text format) files that detail the key figures leading to the final ECA amount for a syndicate, including the corridor values (see Appendix). RTF files for members will be unchanged from previous releases.

E-mail Help Line

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

<mailto:Lloyds-RBC-Help@lloyds.com>

The helpline will be staffed by the MRRU and will provide assistance with all software installation / distribution and member-specific queries as quickly as possible. Wherever possible, agents are requested to use the e-mail help line to resolve queries in preference to telephoning.

If you require any more information, please contact:

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Appendix

Economic Capital Assessment requirements for Syndicates writing on the 2006 year of account

Managing Agent Code:

Managing Agent Name:

Syndicate	Capacity (£)	ICA + Economic Capital Loading (£) (%)	Capital under old market average basis (£) (%)	Lower Corridor (£)	Upper Corridor (£)	Economic Capital Assessment (ECA) (£) (%)
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This information may be price-sensitive

Notes:

Operating Risk factors have only been updated in respect of new syndicates.

An Economic Capital uplift of 35% has been applied to agreed ICAs.

The lower and upper corridor are calculated as 15% either side of the old market average capital basis.

New syndicate loadings, are included under old market average basis but are not applied to ICA.

The ICA number is that proposed by Lloyd's following review of ICA and is not necessarily agreed with the managing agent.

Where review has not been completed, capital under the old market average basis is used.