

MARKET BULLETIN

REF: Y4340

Title	Claims Equalisation Reserves – information for aligned members
Purpose	To explain the operation of Claims Equalisation Reserves and clarify the information which Lloyd's will provide
Type	Information
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Deadline	
Related links	

1. Background

Claims Equalisation Reserves (CERs) were introduced for Lloyd's by Finance Act 2009 to align the tax treatment of Lloyd's corporate members' reserves with the treatment for general insurers. It is hoped that this measure will help to ensure that Lloyd's can continue to compete globally. For Lloyd's members, unlike for general insurers, this is a tax adjustment only and has no impact on reserving for accounts purposes or on capital setting and neither does it require assets to be set aside in a separate fund or ring-fenced in any way.

The purpose of this Bulletin is to provide more detailed information about the calculation of the CER to enable aligned members to calculate their own CER, should they wish to do so. A separate Bulletin has been published (Y4339) to provide members with the following:

- (i) a brief summary of the mechanics of the CER,
- (ii) information about the data that Lloyd's will provide to assist members in the calculation of their CER, and
- (iii) further details of how members compute the transfer in to their CER.

2. Commencement date and timings

The first period for which the CER regime will apply is the year ended 31 December 2008, i.e. the year in which the 2005 year of account profits were declared and are taxed. Lloyd's will provide members with the data necessary to compute their CER for the 2005 year of account, early in 2010. Those members who wish to include the CER adjustment in their 2008 tax return will need to re-file their return in 2010 once the information is made available.

Alternatively, some corporate members may be able to calculate the figures themselves, e.g. those members who are fully aligned. If you choose to calculate your own figures please let us know and we will not provide you with the data calculated centrally. This is in order to avoid any confusion arising due to two sets of data being produced and possible discrepancies arising. The instructions below are provided to ensure that you follow the same methodology as agreed with HMRC.

Please note that Lloyd's CER system is being designed to cater for the majority of Lloyd's members. For some members, the particular facts of their business may mean that their CER calculation needs to be adjusted, for example, if there is a member level reinsurance policy in place. Unfortunately it is not feasible for the central system to deal with all possible scenarios, therefore such members will need to calculate their own CER. Lloyd's will provide them with their premiums and claims data to assist with this. There will be a charge for this.

3 Classes of business and limits

The CER rules only apply to certain classes of business. Members can make transfers into their CER, based on the volume of written premiums for these business classes. Transfers out of the CER are triggered when net claims arising exceed certain limits. The CER is subject to a maximum limit which is computed by reference to average written premiums over a five year period (the current year and the previous 4 years). However, members will be treated as new insurance companies for the purpose of calculating the maximum reserve for the 2005 year of account, i.e. only premiums written on the 2005 year of account will need to be taken into consideration i.e. 2005 pure year results. Any business relating to 2004 year of account and prior which has been RITC'd into 2005 year of account or later should be ignored, as should any movement on any 2004 and prior years of account which are in run off. For the 2006 year of account the written premiums on the 2005 year of account and 2006 year of account will be used and so on, until a full five year average is built up for the 2009 year of account.

The limits applicable to each class of business are as set out below:

Business Group	Transfer in % (applied to net written premiums)	Transfer out % (trigger net claims ratio as a percentage of net written premiums)	Maximum Reserve % (applied to 5 year average of net written premiums)
A - Property	3	72.5	20
B - Consequential Loss	3	72.5	20
C - Marine and Aviation	6	95	40
D - Nuclear	75	25	600
E - Non Proportional Treaty	11	100	75

4 Data sources

The data which is needed is the following:

(i) Net written premiums = written premiums for the relevant year of account, net of reinsurance but before deducting acquisition costs.

[This is calculated from submitted SRD fields: Gross Premiums Written + Outward Reinsurance Premiums Written or lines 1 + 2 on form 199.]

(ii) Net claims = claims paid for the relevant year of account, net of reinsurance, including any movement in net technical provisions but excluding any change in provision for claims handling expenses and excluding deferred acquisition costs.

[This is calculated from submitted SRD fields: Gross Claims Paid Excluding ULAE + Claims Paid Reinsurers' Share + Gross: Reported Claims Excluding ULAE + IBNR Claims Excluding ULAE + Unearned Premiums + Unexpired Risk Provision + Reinsurers' Share: Reported Claims Excluding ULAE + IBNR Claims Excluding ULAE + Unearned Premiums + Unexpired Risk Provision or lines 5 + 6 on form 199 + lines 1 + 2 + 4 + 5 + 7 + 8 + 9 + 10 on form 299]. The Unearned Premiums used are gross of deferred acquisition costs.

Line numbers above are those valid for the 2008 SRD return. The fields were named consistently for prior year reports but the line numbers will vary to those stated above.

For each of these measures, the data at the cumulative 36 month point for the closing year of account is required i.e. net claims will be all claims paid during the first 36 months plus closing technical provisions amount at 36 months. The calendar year movement on any years of account (from 2005 onwards) which are in run-off is also required.

The net written premiums and net claims data is required for each of the five classes of business which qualify for CERs. The majority of the data can be analysed in this way by using the data stored at risk code level in the SRD. Lloyd's has reviewed the risk codes and produced a mapping document which shows how the risk codes are allocated to each of the five CER classes of business. This document is attached at Appendix 1 for reference.

However, there are two pieces of additional analysis which will need to be done by managing agents. The first is to identify the Consequential Loss business, i.e. the business which falls within CER class B, since this is likely to form part of the Miscellaneous and Pecuniary Loss risk code data and can not be separately identified from the SRD. The second is to split out the Non-Proportional Treaty element of the Property Business and the Consequential Loss business, i.e. the part which falls within CER class E. Managing agents will receive a separate request from Lloyd's asking them to provide this data although fully aligned syndicates will not need to provide this data to Lloyd's if they are computing their own CER.

5 Calculating the CER

This section explains in detail the methodology for computing the CER which has been agreed with HMRC. Members who choose to compute their own CER should follow the same methodology.

Detail of calculation

Since the CER regime applies for the 2005 year of account onwards, only data relating to the 2005 and subsequent pure years of account will be relevant. The calculation will not pick up data relating to 2004 and prior years of account which have reinsured to close into the 2005 or other later year of account, or are still in run-off.

The calculations prepared by Lloyd's will only use the premiums relating to the current pure year of account. For example, for the 2006 year of account it is only 2006 pure year premiums which are included. There may be additional premiums which relate to the 2005 year of account within the 2006 year of account, but these will be excluded from the calculation on de minimis grounds. Claims data will be included for all pure years of account from 2005 onwards i.e. not just the current pure year.

Members with member level reinsurance contracts in place will need to adjust their premiums and claims data to reflect this. Please refer to Market Bulletin Y4339.

Treatment of RITC

Where a member's participation on a syndicate stays the same from one year of account to the next, the RITC premium paid and received require no adjustment. However, where a member's participation changes, an adjustment needs to be made to the premiums.

If the member's participation increases, then the premium income on the assuming year of account needs to be increased to reflect the fact that the member has received an RITC premium for taking on an increased share of the business. If the member's participation decreases, then the premium income on the ceding year of account needs to be reduced to reflect the fact that the member has paid an RITC premium to reinsure part of the business. In either case the adjustment is calculated by taking the difference between the member's share of the closing reserves on the ceding year of account and their share of the opening reserves on the assuming year of account. A numerical example is provided in Appendix 2.

The methodology above is consistent with the treatment adopted for accounting purposes where a member increases or decreases its share of the syndicate stamp and under Finance Act 2000 s107 when it was in force.

How the calculation works

The percentages referred to below are those set out in INSPRU and are shown in the table above.

The calculation is performed in four steps.

Step 1 - calculate the maximum provision

This is done by applying a set percentage for each class of business to the average net written premiums for that class of business. The maximum provision for each of the five classes of business is added together to get a total maximum provision.

Step 2 - calculate the provisional transfer in

This is done by applying another set percentage for each class of business to the net written premiums for the current year. This gives an amount for each class of business and these are then added up to get the overall provisional transfer in.

Step 3 - calculate the provisional transfer out

This is, for each business class, determined to be the lower of (i) the maximum provision calculated in step 1 and (ii) what is known as the "abnormal loss" for that class. The abnormal loss is the amount by which the net claims exceed the greater of (i) zero and (ii) a set percentage of the net written premium. Once again the provisional transfer out for each class of business is added up to get a total provisional transfer out.

Step 4 - determine the potential CER carried forward and check whether the maximum provision amount means that an additional transfer out is needed

The potential CER carried forward is calculated by taking the brought forward CER (this will be zero for the first year), adding the provisional transfer in amount and subtracting the provisional transfer out amount. If the potential CER carried forward is greater than the maximum provision calculated at step 1 then an additional transfer out is needed to reduce the carried forward provision to the maximum amount.

Other points to note

The CER is carried forward as a single amount rather than a separate reserve for each class of business.

The CER can never be negative. Therefore if the calculation gives a net transfer out in the first year, the CER remains at zero. For subsequent years where the member has already established a CER, transfers out can only be made to the extent that they reduce the CER to zero.

It is possible to waive all or part of a net transfer in to the CER for a particular year. To do this an election must be made within 2 years of the end of the accounting period to which it relates. If a member chooses to do this, they must keep a record of the net transfers in which have been waived. The waived amount must then be set against any future transfers out at the earliest opportunity. A numerical example is provided in Appendix 3.

If you have any questions on the content of this Market Bulletin, please contact Helen Harrison (email: helen.harrison@lloyds.com; telephone: 0207 327 6859) or Juliet Phillips (email: juliet.phillips@lloyds.com; telephone: 0207 327 6839).

Appendix 1

The following tables show the mapping which we are intending to use to allocate business analysed by risk code to the various CER classes of business.

Table A shows the five CER classes and the FSA descriptions. Table B shows the mapping from risk code to CER class or non CER class.

Table A - The five CER classes of business

CER class	Detail
A – Property	<p>Railway rolling stock, Fire and Natural forces, Damage to property</p> <p>include:</p> <p>Direct and facultative business Proportional treaty business</p> <p>exclude:</p> <p>non proportional reinsurance nuclear business</p>
B – Consequential Loss	<p>“risks of loss to the persons incurred attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on”</p> <p>include:</p> <p>Direct and facultative business Proportional treaty business</p> <p>exclude:</p> <p>non proportional reinsurance nuclear business</p>
C – Aviation and Marine	<p>Aircraft, Ships, Aircraft liability, Liability for ships</p> <p>include:</p> <p>Direct and facultative business Treaty business</p>

	<p>exclude:</p> <p>Nuclear business Reinsurance of nuclear business Transport</p>
D – Nuclear	<p>Contracts of insurance against nuclear risks</p> <p>include:</p> <p>Damage business Liability business</p>
E – Non-proportional treaty covering property and consequential loss	<p>Property and Consequential loss except such nuclear business which should be included in Group D.</p>

Table B – Risk Code to CER Class Mapping Table

Risk Code	CER Class
1	Marine and Aviation
2	Marine and Aviation
3	Marine and Aviation
4	Marine and Aviation
5	Marine and Aviation
6	Marine and Aviation
7	Marine and Aviation
8	Marine and Aviation
9	Marine and Aviation
1E	Marine and Aviation
1T	N/A
2E	Marine and Aviation
2T	Marine and Aviation
3E	Property
3T	Marine and Aviation
4E	N/A
4T	Consequential loss may be an element
5T	N/A
6T	Property
7T	N/A
8T	N/A
AG	Property
AO	Marine and Aviation
AP	Marine and Aviation
AR	Marine and Aviation
AW	Marine and Aviation
AX	Marine and Aviation
B	Marine and Aviation
B2	Property
B3	Property
B4	Property
B5	Property
BB	N/A
BD	Property
BS	Consequential loss may be an element
CA	Property
CF	Consequential loss may be an element
CN	Consequential loss may be an element
CP	Consequential loss may be an element
CR	Consequential loss may be an element
CT	N/A

CX	Marine and Aviation
D2	N/A
D3	N/A
D4	N/A
D5	N/A
DC	Property
DM	N/A
DO	N/A
DX	N/A
E2	N/A
E3	N/A
E4	N/A
E5	N/A
E6	N/A
E7	N/A
E8	N/A
E9	N/A
EA	N/A
EB	N/A
EF	Property
EG	Marine & Aviation
EH	Marine & Aviation
ET	Marine & Aviation
EW	Marine & Aviation
F	Property
F2	N/A
F3	N/A
FA	Property
FC	Consequential loss may be an element
FG	Consequential loss may be an element
FM	Consequential loss may be an element
FR	Property
FS	Consequential loss may be an element
G	Marine & Aviation
GC	Marine & Aviation
GH	N/A
GM	N/A
GN	N/A
GP	N/A
GS	Property
GT	N/A
GX	Marine & Aviation
H	Marine & Aviation
H2	Marine & Aviation

H3	Marine & Aviation
HA	Property
HP	Property
HX	Marine & Aviation
JB	Property
K	N/A
KA	N/A
KC	N/A
KD	N/A
KG	N/A
KK	N/A
KL	N/A
KM	N/A
KS	N/A
KT	N/A
KX	N/A
L	Marine & Aviation
L2	Marine & Aviation
L3	Marine & Aviation
LE	Consequential loss may be an element
LJ	Property
LX	Marine & Aviation
M2	N/A
M3	N/A
M4	N/A
M5	N/A
M6	N/A
M7	N/A
MA	N/A
MB	N/A
MC	N/A
MD	N/A
ME	N/A
MF	N/A
MG	N/A
MH	N/A
MI	N/A
MK	N/A
ML	N/A
MM	N/A
MN	N/A
MP	N/A
N	Property
NA	N/A

NB	Property
NC	N/A
NL	Nuclear
NP	Nuclear
NX	Property
O	Marine & Aviation
OX	Marine & Aviation
P	Consequential loss may be an element
P2	Property
P3	Property
P4	Property
P5	Property
P6	Property
P7	Property
PB	Consequential loss may be an element
PC	Consequential loss may be an element
PD	Property
PE	Consequential loss may be an element
PF	Consequential loss may be an element
PG	Property
PI	N/A
PL	N/A
PM	N/A
PN	Consequential loss may be an element
PO	Consequential loss may be an element
PP	Consequential loss may be an element
PQ	Consequential loss may be an element
PR	Consequential loss may be an element
PS	Consequential loss may be an element
PU	Consequential loss may be an element
PW	Consequential loss may be an element
PX	Marine & Aviation
PZ	Consequential loss may be an element
Q	N/A
QL	N/A
QX	N/A
RX	Marine & Aviation
SB	Consequential loss may be an element
SC	Marine & Aviation
SL	Marine & Aviation
SO	Marine & Aviation
SR	Marine & Aviation
SX	Marine & Aviation
T	Marine & Aviation

TC	N/A
TE	Property
TL	N/A
TO	Property
TR	Property
TS	Marine & Aviation
TU	Property
TX	Marine & Aviation
UA	N/A
UC	N/A
V	N/A
VL	N/A
VX	N/A
W	Marine & Aviation
W2	N/A
W3	N/A
W4	N/A
WA	Consequential loss may be an element
WB	Marine & Aviation
WC	N/A
WL	Property
WS	Consequential loss may be an element
WX	Marine & Aviation
X1	Marine & Aviation
X2	Marine & Aviation
X3	Property
X4	N/A
X5	Marine & Aviation
XA	Property
XC	Property
XD	N/A
XE	Marine & Aviation
XJ	Property
XL	N/A
XM	N/A
XP	Property
XR	Property
XT	Marine & Aviation
XU	Property
XX	Property
XY	Marine & Aviation
XZ	Marine & Aviation
Y1	Marine & Aviation
Y2	Marine & Aviation

Y3	Marine & Aviation
Y4	Marine & Aviation
Y5	Marine & Aviation
Y6	Marine & Aviation
Y7	Marine & Aviation
Y8	Marine & Aviation
Y9	Marine & Aviation
ZX	Marine & Aviation

Note 1: Please note that the above mapping indicates that it is likely that an element of Miscellaneous & Pecuniary Loss will qualify as Consequential Loss business. The definition of Consequential Loss is: “risks of loss to the persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on”. Further analysis will be needed to determine this element and this will need to be provided by managing agents.

Note 2: Please note that any non-proportional treaty business included within Consequential Loss or Property will need to be split out separately and allocated to the Non-Proportional Treaty CER business group.

Appendix 2 – Example of adjustment for RITC

Suppose Company A and Company B each participated on Syndicates 1 and 2 for the 2005 and 2006 years of account.

Company A’s participation was 5% on the 2005 year of account and 10% on the 2006 year of account for each syndicate.

Company B’s participation was 10% on the 2005 year of account and 5% on the 2006 year of account for each syndicate.

The premiums and claims data for the two syndicates is shown below.

		2005 YOA		
		Premiums	Claims paid	Technical reserves at 31.12.07
Pure Year of Account data	Syn 1			
	2005	150,000	(45,000)	(25,000)
	Syn 2			
	2005	250,000	(50,000)	(100,000)
		2006 YOA		
		Premiums	Claims paid	Technical reserves at 31.12.08
Pure Year of Account data	Syn 1			
	2005	10,000	(10,000)	(10,000)
	2006	155,000	(60,000)	(35,000)
	Syn 2			
	2005	25,000	(75,000)	(15,000)
	2006	280,000	(100,000)	(200,000)

Company A

Company A's premiums and claims data is therefore as follows:

		2005 YOA				
		Premiums	Paid claims	b/f Tech reserve	c/f Tech reserve	Reserves Movement
Syn 1						
	2005	7,500	(2,250)	0	(1,250)	(1,250)
Syn 2						
	2005	12,500	(2,500)	0	(5,000)	(5,000)
		<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
		20,000	(4,750)	0	(6,250)	(6,250)

		2006 YOA				
		Premiums	Paid claims	b/f Tech reserve	c/f Tech reserve	Reserves Movement
Syn 1						
	2005	0	(1,000)	(2,500)	(1,000)	1,500
	RITC of 2005 into 2006	1,250				
	2006	15,500	(6,000)	0	(3,500)	(3,500)
Syn 2						
	2005	0	(7,500)	(10,000)	(1,500)	8,500
	RITC of 2005 into 2006	5,000				
	2006	28,000	(10,000)	0	(20,000)	(20,000)
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		49,750	(24,500)	(12,500)	(26,000)	(13,500)

Company A has an adjustment to its premiums in 2006 due to the fact that its participation on the syndicates increases and therefore it effectively receives an RITC premium equal to the difference between the 2005 carried forward reserves and the 2006 brought forward reserves.

So, from this, the premiums and claims figures which are used for CER purposes are:

	2005 YOA	2006 YOA
Net written premiums	20,000	49,750
Net claims	(11,000)	(38,000)

This data needs to be extracted for each CER class of business.

Company B

Company B's premiums and claims data is as follows:

		2005 YOA				
		Premiums	Paid claims	b/f Tech reserve	c/f Tech reserve	Reserves Movement
Syn 1						
2005		15,000	(4,500)	0	(2,500)	(2,500)
RITC of 2005 into 2006		(1,250)				
Syn 2						
2005		25,000	(5,000)	0	(10,000)	(10,000)
RITC of 2005 into 2006		(5,000)				
		<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
		33,750	(9,500)	0	(12,500)	(12,500)

		2006 YOA				
		Premiums	Paid claims	b/f Tech reserve	c/f Tech reserve	Reserves Movement
Syn 1						
2005		0	(500)	(1,250)	(500)	750
2006		7,750	(3,000)	0	(1,750)	(1,750)
Syn 2						
2005		0	(3,750)	(5,000)	(750)	4,250
2006		14,000	(5,000)	0	(10,000)	(10,000)
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		21,750	(12,250)	(6,250)	(13,000)	(6,750)

Company B has an adjustment to its premiums in 2005 due to the fact that its participation on the syndicates decreases from 2005 to 2006 and therefore it effectively pays an RITC premium equal to the difference between the 2005 carried forward reserves and the 2006 brought forward reserves.

So, from this, the premiums and claims figures which are used for CER purposes are:

	2005 YOA	2006 YOA
Net written premiums	33,750	21,750
Net claims	(22,000)	(19,000)

This data needs to be extracted for each CER class of business.

Appendix 3: Example showing effect of waiving a net transfer in

Case (i) – Waiver is made

Year of account	CER b/f	Max provision	Net of potential transfers in and out	Net transfer in waived	Offset of waived transfers in against transfers out	Actual transfer in/(out)	Waived transfers in c/f	CER c/f	Notes
2005	0	17,000	3,000	0	0	3,000	0	3,000	1
2006	3,000	30,000	7,000	7,000	0	0	7,000	3,000	2
2007	3,000	25,000	6,000	0	0	6,000	7,000	9,000	3
2008	9,000	28,000	(2,000)	0	2,000	0	5,000	9,000	4
2009	9,000	24,000	(7,000)	0	5,000	(2,000)	0	7,000	5
Total						7,000			

Notes:

1. Transfer in is made as normal.
2. Transfer in is waived so the CER does not change.
3. Transfer in is made as normal.
4. Calculation gives a net transfer out, so the waived transfer in has to be offset against this.
5. There is a further transfer out which uses up the remainder of the waived transfer in.

Case (ii) – No waiver is made

Year of account	CER b/f	Max provision	Net of potential transfers in and out	Net transfer in waived	Offset of waived transfers in against transfers out	Actual transfer in/(out)	Waived transfers in c/f	CER c/f
2005	0	17,000	3,000	0	0	3,000	0	3,000
2006	3,000	30,000	7,000	0	0	7,000	0	10,000
2007	10,000	25,000	6,000	0	0	6,000	0	16,000
2008	16,000	28,000	(2,000)	0	0	(2,000)	0	14,000
2009	14,000	24,000	(7,000)	0	0	(7,000)	0	7,000
Total						<u>7,000</u>		

Therefore the total transfers in and out over the period are the same in each case once the waived transfer in has been offset in full against transfers out.