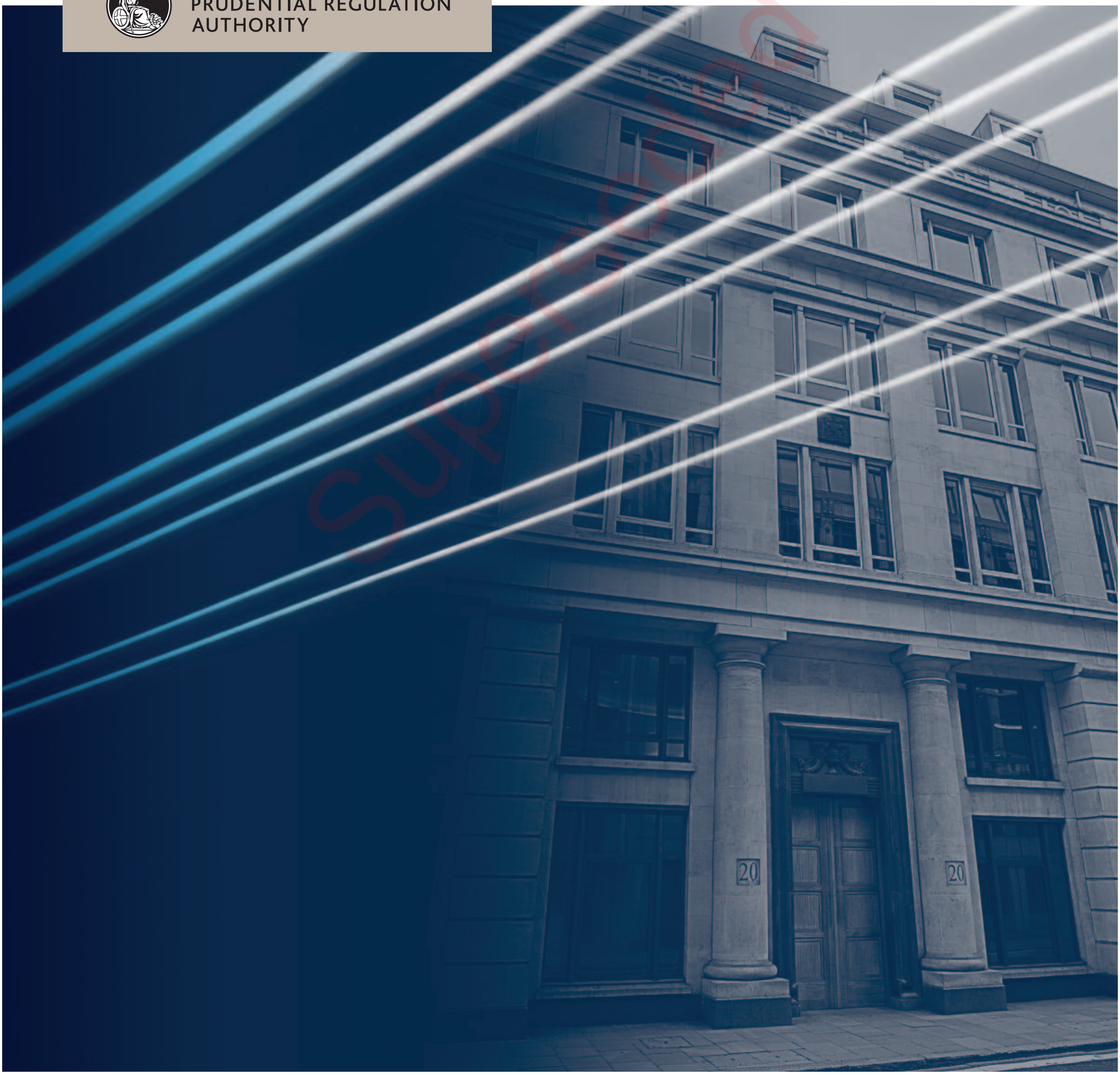
Supervisory Statement | SS12/15

Appendix 2.12

Solvency II: Lloyd's

March 2015

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



Prudential Regulation Authority
20 Moorgate
London EC2R 6DA

Prudential Regulation Authority, registered office: 8 Lothbury, London EC2R 7HH.
Registered in England and Wales No: 07854923

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Supervisory Statement | SS12/15

Solvency II: Lloyd's

March 2015

1 Introduction

1.1 This supervisory statement is addressed to Lloyd's. It sets out the Prudential Regulation Authority's (PRA's) expectations in relation to the application of certain parts of Solvency II to Lloyd's, and expands upon the Lloyd's Part of the PRA Rulebook.

1.2 In particular, this statement sets out the PRA's expectations regarding the following topics:

- amendments to trust deeds;
- solvency capital requirement (SCR);
- capital add-ons; and
- composites.

1.3 This statement expands on the PRA's general approach as set out in its insurance approach document.(1) By clearly and consistently explaining its expectations of Lloyd's in relation to the particular areas addressed, the PRA seeks to advance its statutory objectives of ensuring the safety and soundness of the firms it regulates, and contributing to securing an appropriate degree of protection for policyholders. The PRA has considered matters to which it is required to have regard, and it considers that this statement is compatible with the Regulatory Principles and relevant provisions of the Legislative and Regulatory Reform Act 2006. This statement is not expected to have any direct or indirect discriminatory impact under existing UK law.

1.4 This statement has been subject to public consultation(2) and reflects the feedback that was received by the PRA.

2 Amendments to trust deeds, standard form letters of credit and guarantee arrangements

2.1 Except in urgent cases, the PRA expects the Society to consult members, managing agents and other interested parties in the Lloyd's market in relation to any proposed new Lloyd's trust deed or amendments to any existing deed before the new deed or amendments take effect.

2.2 The PRA would normally expect to receive the information required in Lloyd's 6.3 for any new or amended Lloyd's trust deed not less than three months in advance of the proposed change.

2.3 The PRA would also expect the Society to apply the approach in paragraphs 2.1 and 2.2 above in case of amendments to standard form letters of credit and guarantee arrangements.

3 Solvency capital requirement

3.1 The requirement to hold eligible own funds covering the central requirement is intended to ensure that risks to the Society, including risks to central assets (and in particular, the risk that own funds attributable to a member may not be sufficient to enable the member to meet obligations arising from the member's insurance business at Lloyd's) are suitably covered by the Society.

3.2 Solvency Capital Requirement — General Provisions 6.6 recognises in its application to Lloyd's that own funds attributable to a member are not available to absorb the losses of other members, or any losses of the Society. Consequently, in respect of own funds attributable to a member, where there is no diminution in those own funds consequent upon the application of scenarios taken into account in the internal model, those own funds attributable to that member must not be taken into account for the purposes of satisfying Solvency Capital Requirement — General Provisions 6.2. Similarly, in respect of own funds attributable to a member, any surplus of own funds in excess of the diminution to those own funds consequent upon the application of the scenarios taken account of in the internal model, must not be taken into account for the purposes of satisfying Solvency Capital Requirement — General Provisions 6.2.

3.3 The notional syndicate SCR is intended to facilitate the Society's compliance with Solvency Capital Requirement — General Provisions 8.2. While the PRA expects the calculation of the notional SCR to meet the relevant standards required under Solvency II, managing agents do not need to seek separate approval from the PRA for any internal model that is used to calculate the notional SCR of a syndicate. The notional SCR will also assist the Society in determining the notional SCR of each member of the syndicate pursuant to Solvency Capital Requirement — General Provisions 8.4. However, the notional member SCR will, to the extent applicable, also take account of diversification effects in respect of members participating on more than one syndicate which have not been reflected in the notional syndicate SCR.

3.4 In deriving the SCR, the Society should have regard to the notional SCR for each syndicate, that is calculated by managing agents either by reference to the standard formula or an internal model. However, the Society should make its own assessment of the risk profile and governance arrangements in respect of each syndicate, in conjunction with

(1) *The Prudential Regulation Authority's approach to insurance supervision*, June 2014; www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1406.pdf.
(2) *PRA Consultation Paper CP16/14*, 'Transposition of Solvency II: Part 3', August 2014; www.bankofengland.co.uk/pra/Documents/publications/cp/2014/cp1614.pdf.

the methodology applied by each managing agent to calculate the notional SCR. It may need to increase a notional syndicate SCR, and hence the overall SCR for Lloyd's, if it concludes that there are additional risks to which the Society is exposed in relation to the business written by a syndicate, that would not otherwise be covered, when performing the calculations envisaged by Solvency Capital Requirement — General Provisions 7.

3.5 The approach set out in Solvency Capital Requirement — Internal Models 17.2 is, when combined with the internal model requirements set out in Solvency Capital Requirement — Internal Models 10 to 16 and Solvency Capital Requirement — General Provisions 8.2, intended to produce, for each risk taken into account in the internal model, the negative impact on basic own funds at Lloyd's. In this way, the effect of the application of the risks taken into account in the internal model may be determined in respect of Lloyd's as a whole.

4 Capital add-on

4.1 Solvency Capital Requirement — General Provisions 7.3 requires the Society to calculate a central requirement for Lloyd's. As the central requirement forms part of the Lloyd's SCR, the provisions of Article 37 of the Solvency II Directive will apply in respect of any risk profile deviation on the part of the Society from the assumptions underlying the calculation of the central requirement. The PRA will use its powers under section 55M of the Financial Services and Markets Act 2000 (FSMA) in order to apply any capital add-on to the Society. The Solvency II Regulations also apply in relation to the imposition of a capital add-on.

5 Composites

5.1 As Lloyd's is (and was prior to 15 March 1979, being the relevant date set out in the Solvency II Directive) composed of syndicates which separately accept general insurance business or long-term insurance business, the PRA considers Lloyd's to be a composite undertaking for the purposes of the Solvency II Directive.

5.2 The Solvency II Directive requires composite firms to maintain separate management of general insurance business and long-term insurance business. In practical terms, this requires that managing agents separately manage syndicates which carry on general insurance business from syndicates which carry on long-term insurance business. However, where a single syndicate carries on both general insurance business and long-term insurance business pursuant to the exceptions referred to at Composites 6.2 in the Composites Part of the PRA Rulebook, paragraphs 3.1–3.3 of *Supervisory Statement SS8/15* on Composites (Appendix 2.8) are intended to assist in determining how the requirements of the Composites Part will apply to managing agents.

5.3 Paragraphs 2.1–2.3 of SS8/15 refer to a firm's permission to effect and/or carry out contracts of insurance which may be general insurance business or long-term insurance business, or both, and, within those categories, to the particular classes of insurance business. For the purpose of the application of rules in the Composites Part to Lloyd's, references in paragraphs 2.1–2.3 of SS8/15 to a firm's 'permission' in respect of 'classes' of insurance business are to be interpreted by reference to syndicates which carry on what would be, as the context requires:

- general insurance business, if the syndicate was a firm authorised to effect and/or carry out contracts of general insurance business;
- long-term insurance business, if the syndicate was a firm authorised to effect and/or carry out contracts of long-term insurance business; and
- both general insurance business and long-term insurance business, if the syndicate was a firm authorised to effect and/or carry out both contracts of general insurance business and contracts of long-term insurance business, as contemplated by paragraph 2.3 of SS8/15.

5.4 The references in Composites 2.2 to 'general insurance business' and 'long-term insurance business', and the activities relating thereto, are to be similarly interpreted.