DIRECTOR BRIEFINGS
SOLVENCY II & REGULATORY UPDATE

17 & 18 April 2013

AGENDA

- Introduction
- Solvency II
- Market Interaction
- Regulatory Update
- Questions

WHERE DID WE LEAVE IT LAST TIME…

- Solvency II implementation delayed but revised timetable uncertain
- Year end attestation due to the FSA on managing agent progress
- Use of Solvency II calibrated models for capital setting in 2013
- Phased transition of qualitative elements to BAU by 2015
- 2013 focus on review of Minimum Standards and broader risk oversight

...AND HAS ANYTHING CHANGED?

- Solvency II timetable still uncertain
- Year end attestation made to the FSA
  - 84% of the market (by materiality) meeting “the principles” of the tests and standards (T&S) with limited work outstanding for others against principles
  - more work outstanding against full T&S for all agents
- Risk Assurance Function established wef 1 January 2013
  - Standards review work in early stages
- New Capital & Planning Group (CPG) established in response to market feedback
  - aim is a more efficient, effective and transparent process
  - operational for 2014 plan and capital setting

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NO REVISED SOLVENCY II TIMETABLE YET ISSUED BY EUROPEAN COMMISSION

- Current stance by EC is no ‘Quick Fix 2’ legislation proposed
  - would mean technical application of new regime at 1 January 2014 but **unlikely to** be enforced in practice
  - earliest practical start date still 1 January 2016 but could be later
- PRA will not extend interim requirements beyond ICAS+ transition
  - permits firms to use Solvency II calibrated models to meet ICAS
  - aligns with Lloyd’s “soft landing” approach for managing agents
- EIOPA’s focus now on applying “interim measures”
  - published 27 March 2013 for consultation

INTERIM MEASURES DESIGNED TO ENCOURAGE HARMONISED TRANSITION WEF JANUARY 2014

- **Pre-application** for internal models
- **Pillar 2 proposals** consistent with Lloyd's published transition plans
  - System of governance
  - Forward looking risk assessment based on ORSA principles
- **Pillar 3 requirements** are substantial and duplicative
  - Solvency 1 requirements would still apply
- EIOPA consultation open until 19 June
  - Lloyd's will respond in consultation with LMA, via Insurance Europe
- Final measures will be published late 2013

SOFT LANDING DOES NOT REQUIRE FULL COMPLIANCE WITH ALL TESTS AND STANDARDS IN 2013

- However, agents expected to continue to run and embed processes as per operating model
- Quantitative submissions made using Solvency II internal models to meet ICAS+
- Key supporting qualitative processes expected to be live and evidenced in line with agreed policies:
  - ORSA
  - Model Validation
  - Model Change governance and reporting
  - Documentation controls and updates
  - Actuarial Function Report
- Lloyd’s will continue to provide and follow up on feedback
- Important to maintain compliance with principles <u>AND</u> continue to close gaps against tests and standards
- Board declaration and confirmation of status required in October 2013

COMMON ISSUES DRIVING "FAILS" ON PRINCIPLES

AREA/PRINCIPLE	ISSUES OUTSTANDING
ORSA	• Stress & scenario testing • Forward looking assessment • Clear conclusions and management actions
Validation	• Evidence of feedback loop and follow up/tracking of validation failures • Validation report does not provide sufficient evidence of validation work performed and conclusions
Model Change	• Clear rationale for change triggers • Clear approach for the aggregation of minor changes
Use Test	• Q4 2012 interviews did not support understanding of model or effectiveness of board training • Evidence of actual model use outside of running SCR
Documentation	• Submitted documents do not support controls and processes established • Documents do not explicitly cover tests and standards requirements

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NEW CPG WILL HAVE QUANTITATIVE FOCUS

- Assessment criteria and guidance to be issued at the start of each planning cycle
- More time spent earlier in the year sharing Lloyd's view of market conditions and agents' growth / development intentions
- Lloyd's will share consolidated view of each syndicate in advance of the first business plan and capital submission
  - agent specific virtual team across all relevant areas will support the CPG
  - input from new Standards Assurance Group (SAG) on qualitative aspects
- Managing agents will receive formal written feedback post approval
  - Tom Bolt, Director Performance Management, and Luke Savage, Director Finance and Operations, will act as a joint appeal panel

REMINDER OF RATIONALE FOR STANDARDS UPDATE

- 7 published sets of Lloyd's minimum standards
  - some not updated since 2005
  - inconsistency in design and application
- Solvency II requirements
  - previously managed as distinct project
  - some overlaps and gaps
- Changing regulatory requirements
  - PRA/FCA split
  - SOLPRU to replace current handbook

WHAT WILL THE REVISED STANDARDS AND NEW RISK ASSURANCE FUNCTION PROVIDE?

- **A clear framework within which all Managing Agents are expected to operate**
  - One set of standards covering all requirements
  - Clarity on regulatory vs Lloyd's requirements vs "aspirational"
  - Alignment to Solvency II and changing regulatory requirements
  - Consistency in interpretation, presentation and publication
- **A clear control framework for Lloyd's which demonstrates robust oversight of the market**
  - Clear view of an agent against all requirements at any point in time
  - Clear linkage between decision making forums and view on an agent
  - Transparency in review processes and outcomes with agents
  - Evidence to PRA and FCA

UPDATE IS A REVIEW AND REFRESH OF EXISTING STANDARDS

Update will provide:

- ✓ An opportunity to remove redundancy/duplication and align with Solvency II requirements
- ✓ Clear definition between “requirements” and “guidance”
- ✓ Consistency in presentation and interpretation
- ✓ User friendly format and structure

Will not be:

- ✗ A backdoor introduction of “new” requirements
- ✗ Gold-plating via best practice minimums
- ✗ Repetition of all regulation – e.g. FSA handbook

PROGRESS AND NEXT STEPS

- Risk Assurance team now operational within Risk Management
- SAG terms of reference to be finalised and begin operating in Q2 2013
- Standards re-write work has started with market consultation via LMA
- LMA Risk Assurance Committee established
  - work in progress on Governance standards “pilot” with small sub group
  - agreed approach and principles will be applied to other standards
- Concurrent work on hosting system options
- On-going discussions with PRA on proposed approach to market oversight

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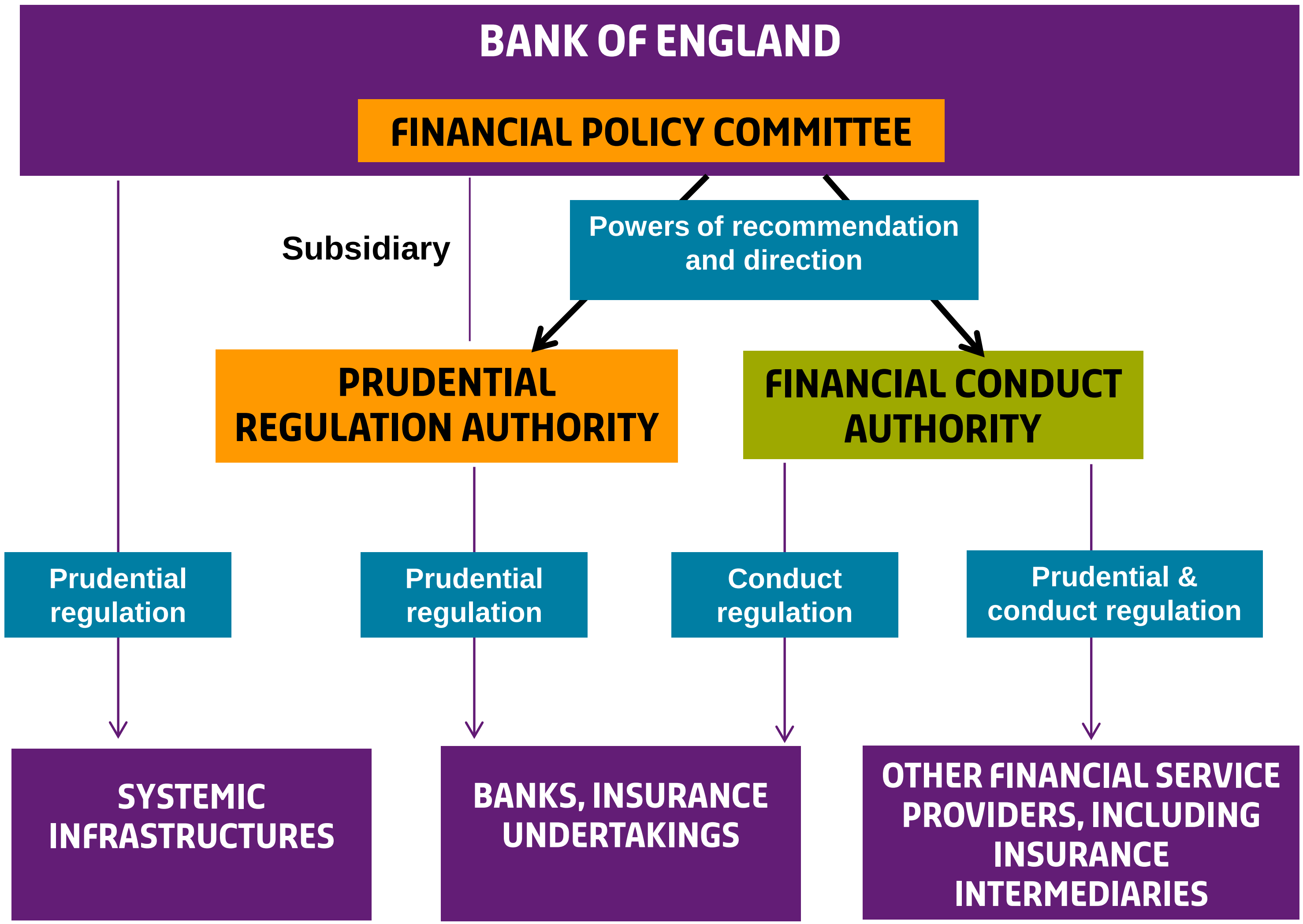
NEW UK SUPERVISORY STRUCTURE



PRA PRUDENTIAL SUPERVISION OF INSURERS

PRA Objectives

- **General objective:** To promote firms' safety & soundness and the stability of the UK financial system
- **Insurance objective:** To secure appropriate protection for policyholders

PRA approach to supervision

- Reliance on judgement
- Forward-looking
- Focus on issues and insurers posing greatest risk
- Rigorous and well-documented regulatory decision-making

PRA's supervision of Lloyd's

- **Two principles:**
- The Lloyd's market should be supervised to the same standards as UK insurers
- Supervision will take place primarily at the level in the market where risk is managed

FCA CONDUCT SUPERVISION OF INSURERS

FCA Objectives

- **Strategic objective:** To ensure that relevant markets function well
- **Operational objectives:** Consumer protection; market integrity and competition

FCA approach to supervision

- Pro-active (not reactive) regulation
- Root cause analysis to look at business models
- Focus on early intervention
- Low tolerance for customer detriment

FCA supervisory model

- **Firm Systemic Framework –** structured conduct assessment.
- **Event-driven work** – dealing with problems
- **Issues and products –** campaigns on sectors and products putting consumers at risk

OTHER CURRENT REGULATORY TOPICS

- **Sanctions** breaches pose reputational / brand risk as well as the risks to Lloyd's licences
- Lloyd's needs to be satisfied with the level of oversight it has over the market's sanctions and financial crime controls
- Review approach developed- currently being 'piloted' with two firms in the market
- Requirement for all agents to conduct review by Internal Audit between June 2013 and end of Q2 2014

- **DG Competition** review of subscription markets
  - Outcome favourable
  - Demonstrating competition law compliance remains very important

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