



# DIRECTOR BRIEFINGS RISK UPDATE

15 & 16 October 2013

# AGENDA

- ▶ **Introduction**
- ▶ **Solvency II**
- ▶ **Risk Assurance**
- ▶ **Regulatory Update**
- ▶ **Questions**

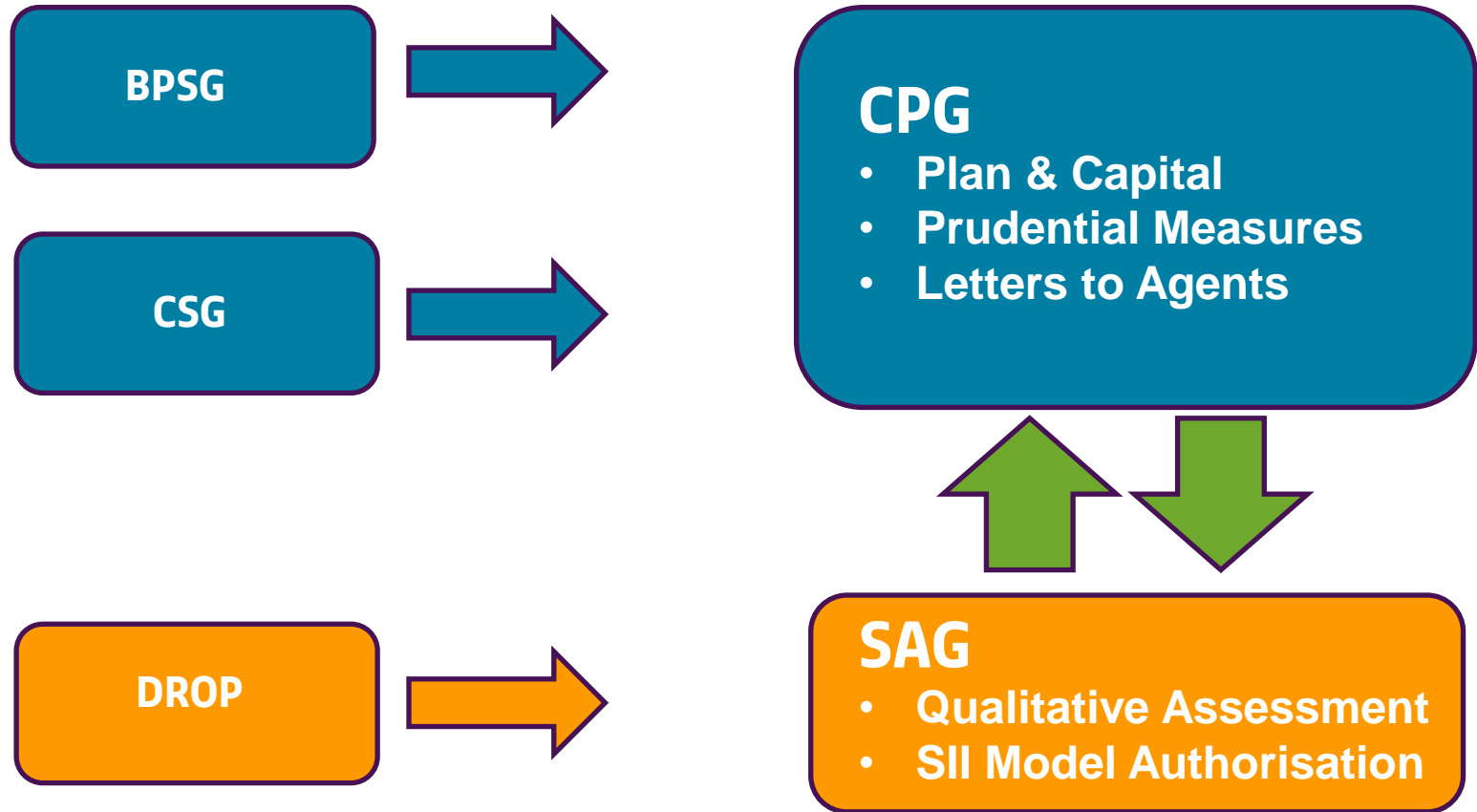
# WHERE DID WE LEAVE IT LAST TIME...

- ▶ Solvency II timetable still uncertain
  
- ▶ Risk Assurance Function established wef 1 January 2013
  - LMA Risk Assurance Committee set up
  
  - Standards review work in early stages
  
- ▶ New Capital & Planning Group (CPG) established in response to market feedback

# ...AND HAS ANYTHING CHANGED?

- ▶ Solvency II timetable still uncertain
- ▶ Capital & Planning Group (CPG) established and 2014 YOA review is on-going
- ▶ Risk Assurance Function up and running
  - Review framework project within the corporation is on-going
  - Progress continues to be made with the LMA on the standards refresh
- ▶ The Dry Run Oversight Panel (DROP) superseded by Standards Assurance Group (SAG) established wef 1 July 2013
  - Assess Managing Agent compliance with Lloyd's & Solvency II Standards
  - Authorise the use of syndicate internal models for capital setting & provide input to CPG
  - Authorise syndicate major model changes (when in a live environment)

# DECISION MAKING FORUMS

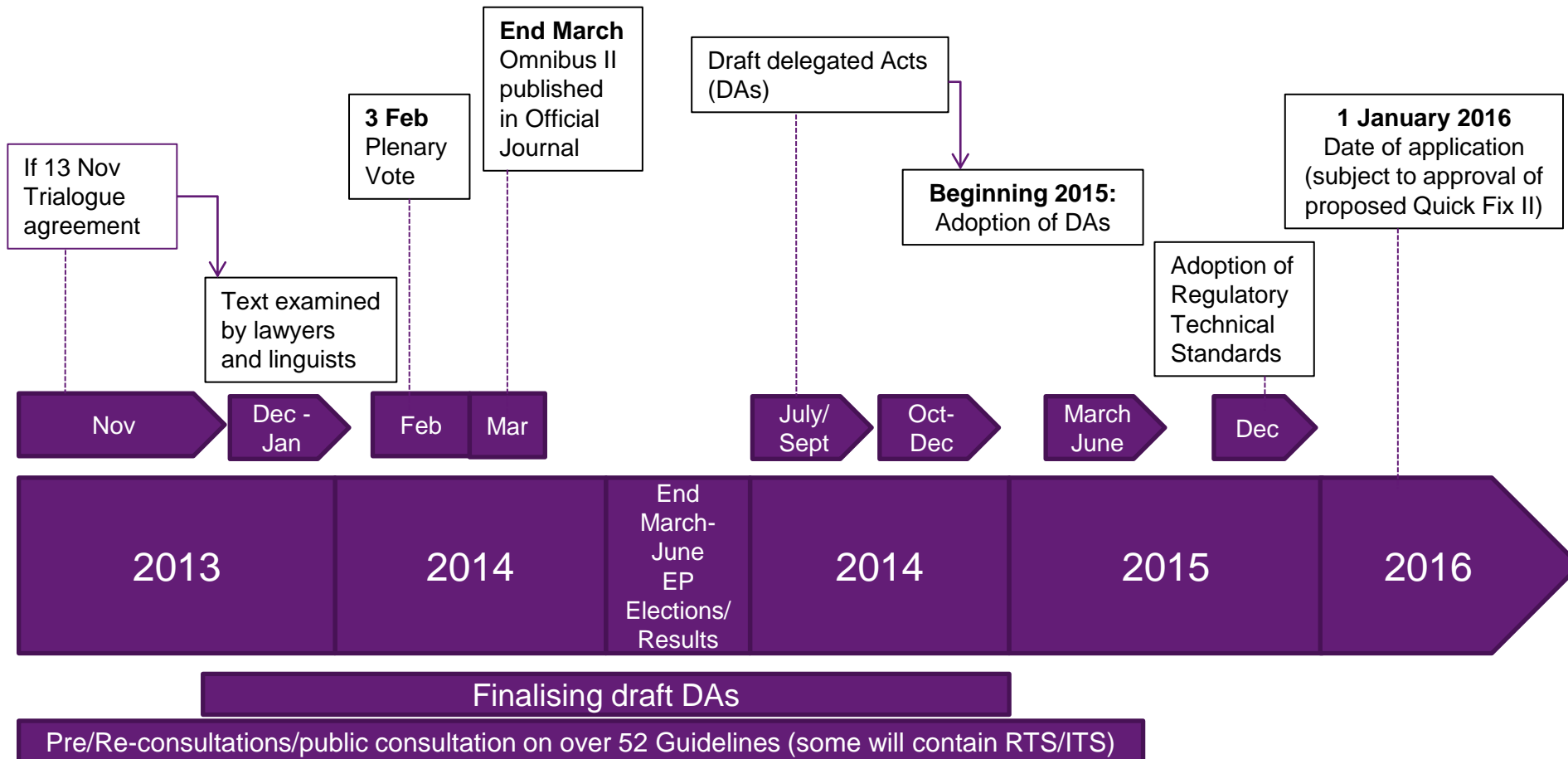


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# OMNIBUS II/SOLVENCY II POTENTIAL TIMETABLE

- ▶ EU to formally postpone implementation date to 1 January 2016
- ▶ Pressure to finalise Omnibus II
- ▶ Level 2 measures will follow Omnibus II



# EIOPA AND PRA PROVIDING STEPPING STONES TO SOLVENCY II

- ▶ EIOPA Interim Measures cover Pillar 2 and Pillar 3
  - Final measures published September 2013 following consultation earlier this year
  - Phased introduction of Pillar 2 measures from 2014, consistent with Lloyd's current approach
  - Pillar 3 requirements to apply from 31 December 2014
  - PRA to issue a Supervisory Statement to UK firms setting out what firms will be required to do with respect to compliance with the Guidelines.
  
- ▶ PRA moving towards ICAS+
  - Capital setting using Solvency II internal models and balance sheets consistent with Lloyd's approach
  - Potential impact of 'Early Warning Indicators' unclear and of concern

**... NO ISSUE FOR LLOYD'S DUE TO "SOFT LANDING"**



# 2013 “SOFT LANDING” APPROACH

- ▶ Quantitative requirements apply immediately to support use of Solvency II models. Hard Test submissions treated as BAU and should comply with all relevant requirements
- ▶ Qualitative requirements phased in over 2013 to 2016. Soft Test submissions should be made on a best efforts basis

Quantitative – hard test	Qualitative – soft test
SCR	ORSA
TPD Return	Actuarial Function Report
GQD Return	Model Change Report
Solvency II Balance Sheet (QMC)	Validation Report
LIM Asset Return (QAD)	

- ▶ Draft Solvency II timetable for 2014 to be published later in 2013

# GOOD PROGRESS ON MEETING THE PRINCIPLES

## COMMON ISSUES DRIVING “FAILS” ON PRINCIPLES OF SOLVENCY II

January 2013

ORSA

Validation

Use Test

Documentation

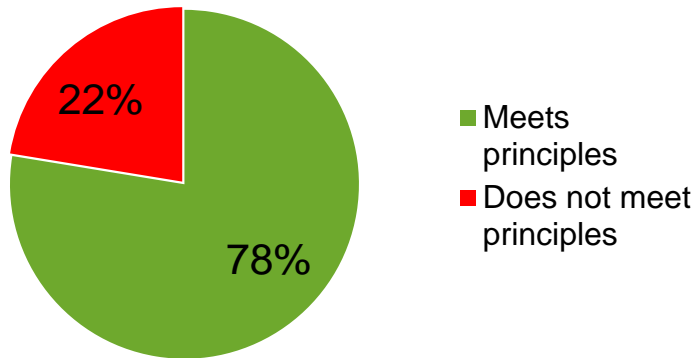


October 2013

ORSA

Use Test

### SAG ASSESSMENT TO DATE BY AGENT



- ▶ Still significant work for agents to complete before they meet the full tests and standards, particularly:
  - ORSA
  - Actuarial Function Report
  - Supervisory Reporting
- ▶ As well as many managing agent specific development areas
- ▶ These will form the focus of our 2014 activity

# BOARD CONFIRMATION OF SOLVENCY II STATUS

- ▶ Submission due 25 October
- ▶ Lloyd's expectations of Board members:
  - Understanding of where gaps are and what is required to close them
  - Understanding of where Lloyd's view and agents view differs

WORKSTREAM/ELEMENT	MEETS THE PRINCIPLES OF THE TESTS & STANDARDS		MEETS THE FULL TESTS & STANDARDS		COLUMN 5 - COMMENTS <small>PLEASE PROVIDE RATIONALE FOR ANY CHANGES MADE TO AGENT STATUS IN COLUMN 2 AND/OR COLUMN 4</small>	
	COLUMN 1 LLOYD'S	COLUMN 2 AGENT	COLUMN 3 LLOYD'S	COLUMN 4 AGENT		
<b>INTERNAL MODEL SCR</b>						
IMSCR002	Insurance risks	Yes	Yes	Yes	Yes	No changes
IMSCR003	Other risks	Yes	Yes	Yes	Yes	No changes
IMSCR004	Aggregate SCR	Yes	Yes	Pending	Pending	No changes
<b>VALUATION AND BALANCE SHEET</b>						
VBS002	Valuation of assets & liabilities (excluding technical provisions)	Yes	Yes	Yes	Yes	No changes
<b>TECHNICAL PROVISIONS AND STANDARD FORMULA</b>						
TPSF002	Standard formula SCR	Yes	Yes	Yes	Yes	No changes
TPSF003	Valuation process	Yes	Yes	Yes	Yes	No changes
TPSF004	Valuation methodology	Yes	Yes	Pending	Pending	No changes
TPSF005	Data	Yes	Yes	Yes	Yes	No changes
TPSF006	TP Assumptions	Yes	Yes	Yes	Yes	No changes
TPSF007	Validation	Yes	Yes	Pending	Pending	No changes
<b>MODEL VALIDATION</b>						
MVALD002	Probability distribution forecast and risk ranking	Yes	Yes	Pending	Pending	No changes
MVALD003	Methodological adequacy	Yes	Yes	Yes	Yes	No changes
MVALD004	Methodological consistency and credibility	Yes	Yes	Yes	Yes	No changes
MVALD005	Assumptions	Yes	Yes	Yes	Yes	No changes
MVALD006	Data directory and data policy	Yes	Yes	Yes	Yes	No changes
MVALD007	Dependencies	Yes	Yes	Pending	Pending	No changes
MVALD008	Risk mitigation techniques	Yes	Yes	Yes	Yes	No changes
MVALD009	Final gtees and options, future mgmt actions and non cont pymts	Yes	Yes	Yes	Yes	No changes
MVALD010	Calibration	Yes	Yes	Pending	Pending	No changes
MVALD011	Validation	Yes	Yes	Pending	Pending	No changes
MVALD012	Profit and loss attribution and backtesting	Yes	Yes	Pending	Pending	No changes
MVALD013	Model robustness and stress and scenario testing	Yes	Yes	Yes	Yes	No changes
MVALD014	External models and data	Yes	Yes	Yes	Yes	No changes
<b>GOVERNANCE, RISK MANAGEMENT AND USE</b>						
GRMUD002	General governance requirements	Yes	Yes	Pending	Pending	No changes
GRMUD003	Fit and proper	Yes	Yes	Yes	Yes	No changes
GRMUD004	Risk management	Yes	Yes	Yes	Yes	No changes
GRMUD005	Internal control	Yes	Yes	Yes	Yes	No changes
GRMUD006	Internal audit	Yes	Yes	Pending	Pending	No changes
GRMUD007	Actuarial function	Yes	Yes	Pending	Pending	No changes
GRMUD008	Outsourcing	Yes	Yes	Yes	Yes	No changes
GRMUD009	Risk Coverage	Yes	Yes	Yes	Yes	No changes
GRMUD010	Use test	Yes	Yes	Pending	Pending	No changes
GRMUD011	Model governance	Yes	Yes	Yes	Yes	No changes
GRMUD012	Model change policy	Yes	Yes	Pending	Pending	No changes
GRMUD013	ORSA process	Yes	Yes	Pending	Pending	No changes
GRMUD014	ORSA documentation	Yes	Yes	Pending	Pending	No changes
GRMUD015	ORSA outcomes	Yes	Yes	Pending	Pending	No changes
<b>REPORTING AND DISCLOSURE</b>						
SREPO02	Supervisory reporting and disclosure	Yes	Yes	No	No	No changes
<b>DOCUMENTATION AND FINAL APPLICATION</b>						
DFAD002	Documentation process	Yes	Yes	Pending	Pending	No changes
DFAD003	Design and operational details	Yes	Yes	Yes	Yes	No changes
DFAD004	Theory, assumptions, mathematical and empirical basis	Yes	Yes	Yes	Yes	No changes
DFAD005	Circumstances where the model does not work effectively	Yes	Yes	Yes	Yes	No changes
DFAD006	Model change documentation	Yes	Yes	Pending	Pending	No changes
DFAD007	Final application pack	Yes	Yes	Yes	Yes	No changes
<b>GENERAL COMMENTS</b>						
<b>DECLARATION</b>						
We confirm that:						
<ul style="list-style-type: none"> <li>• The status above properly reflects the current status of progress on all workstreams and all feedback received to date</li> <li>• Sufficient evidence to substantiate completion is available for Lloyd's review if required</li> </ul>						

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# RISK ASSURANCE HIGH LEVEL UPDATE

- ▶ Significant progress towards refreshing the current minimum standards has been made, however the 1 January 2014 launch date was aspirational
- ▶ The standards timetable has now been adjusted:
  - Full consultation on all standards will complete by the end of Q1 2014
  - Q2 2014 used for Executive Team and Franchise Board sign off and consistency review
  - Standards will be launched 1 July 2014
- ▶ Work on-going to revise the web based presentation of the standards
  - Improved structure and clarity over current standards section
- ▶ Continued progress on Lloyd's Standards Framework update
- ▶ Senior Nominated Person (SNP) role extended to include responsibility for compliance with Lloyd's standards
  - Workshops will be run in Q1 2014 to explain the new approach

# WHY ARE WE REFRESHING THE STANDARDS?

- ▶ One set of standards covering all requirements for Managing Agents
  - A clear framework within which all Managing Agents are expected to operate
  - Consistency in interpretation, presentation and publication
  - Alignment to new Solvency II and PRA requirements
  - Consistency in interpretation, presentation and publication

## CURRENT STANDARDS

Claims Management  
Risk Management  
Underwriting Management  
Effective operational processes  
Governance  
Management of investment risk  
Reputation & Brand



## REVISED STANDARDS

Governance  
Internal Model  
Underwriting  
Reinsurance  
Delegated Authorities  
Exposure Management  
Risk Management  
Investment Management  
Claims Management  
Ethics & Compliance



**SOLVENCY II**

# GOVERNANCE STANDARD EXAMPLE



**GROUPING**  
HIGH LEVEL SUBJECT  
AREA

System of Governance

**SUBJECT**  
BRIEF DESCRIPTION OF  
THE SUBJECT OF THE  
REQUIREMENT

Effective System of Governance

**STANDARD**

Managing Agents shall have in place an effective system of governance which provides for sound and prudent management of the business.

**REQUIREMENT**

**The system of governance shall:**

- be proportionate to the nature, scale and complexity of the operations of the business
- provide for effective cooperation, internal reporting and communication of information at all relevant levels of the business
- include compliance with the requirements laid down in the SII Framework directive, Articles 42 to 49

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# REGULATORY UPDATE

## INTERNATIONAL

- **Comframe** - International Association of Insurance Supervisors' (IAIS) common framework for enhanced regulation of Internationally Active Insurance Groups (IAIG's)
- **Systemic Risk** – Financial Stability Board's (FSB) regime of enhanced supervision for globally systemic insurance institutions (G-SII's), with significant IAIS input.
- **Recovery and Resolution** – FSB's efforts to ensure large financial institutions fail safely.
- **Branches** – IAIS paper on supervision of cross-border operations through branches

## EUROPE

- **Solvency II** – EU legislation introducing economic risk-based solvency requirements for EU insurers. Significant legislative delays. Earliest expected implementation date January 2016.
- **Insurance Mediation Directive revision (IMD2)** – Extension of existing Directive in progress introducing new requirements for all insurance undertakings

## UK

- **New Financial Services Regulation** -
  - Shift in regulatory approach from the PRA and FCA since April 2013.
  - Lloyd's has an open and constructive relationship with the PRA and the FCA at all levels.

# CONDUCT RISK – FCA OBJECTIVES

- ▶ FCA statutory objective – Ensuring markets work well
- ▶ Supported by 3 operational objectives
  - Protect consumers
  - Protect competition
  - Maintain integrity in the market
- ▶ FCA identifies and assess risks to consumers and firms in the financial services market which threaten these objectives
- ▶ FCA aims to ensure the right firms, run by the right people, selling the right products to the right consumers, are approved to do business.
- ▶ Does the firm have the interests of its customers and the integrity of the market at the heart of how the business is run?

# WHERE IS THE FCA GOING?

- ▶ “the first 100 days of the FCA are a bell weather of things to come....”
- ▶ “Financial services flew too close to the sun in the boom years. They pivoted too far towards commercial interests and too far away from consumer interests”
- ▶ “firms need to sharpen their gut instincts about what’s right and wrong”
- ▶ “Regulators need to serve the market better by acting more swiftly...”

Martin Wheatley 100 days speech July 2013

# FCA - ACTION SO FAR

- ▶ Product intervention: interest only mortgages
- ▶ Reviews so far: motor legal expenses insurance, mobile phone insurance,
- ▶ Ongoing thematic work:
  - personal lines claims handling
  - insurance add-ons
  - brokers conflict of interest
- ▶ Enforcement action: fines on both individuals and firms for failures in relation to complaints handling, sales of insurance add on products, money laundering controls,

# HOW DOES THE FCA SUPERVISE MANAGING AGENTS – RISK ASSESSMENTS

- ▶ FCA has assigned classifications (C1-C4) to managing agents based on their view of the potential impact of that firm/group on the FCA's objectives and number of retail customers
- ▶ C3 firms are supervised by a team of sector specialists but don't have a dedicated supervisor.
- ▶ FCA will look at C3 firms' business models but will look more at firms which are outliers compared to peers
- ▶ FCA will carry out a risk assessment of the business, how it is run and controlled on a 4 year cycle. May carry out interim work if they think the risk represented by the firm is changing

# HOW DOES THE FCA SUPERVISE MANAGING AGENTS – CROSS FIRM ISSUE/PRODUCT WORK

- ▶ In addition to risk assessment work, FCA carries out cross firm issue/product thematic work
- ▶ FCA general data request for insurers (Spring 2013): required managing agents (along with other insurers) to provide data about GWP by class of business, UK/EEA/ROW and whether it was retail, micro-business, commercial or reinsurance.
- ▶ FCA thematic work, for eg:
  - personal lines claims handling
  - mobile phone insurance
  - Motor legal expenses insurance
  - Brokers conflicts of interest

# FCA & LLOYD'S

- ▶ What have we seen?
  - Risk assessments & Data requests
  - Agent's participating in thematic work
  - Feedback – Managing Agents are behind peer group
- ▶ What are we doing?
  - Cooperation Agreement between FCA and Lloyd's
  - Minimum standards work
  - Delegated authorities enhancements
  - New Complaints code

# SANCTIONS UPDATE

- ▶ Recent enquiries from the New York Department of Financial Services ('NY DFS') about the (re)insurance market's compliance controls around sanctions highlights growing regulatory risk.
- ▶ Lloyd's needs to ensure that it has satisfactory oversight of the market's controls.
- ▶ The Market Review pilot has successfully concluded, with the review in roll out across the wider Market.
- ▶ Requirement for all agents to conduct review by Internal Audit by the end of Q2 2014. Currently on target.



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