



SOLVENCY II ORSA & MODEL CHANGE WORKSHOPS

12 & 15 November 2013

AGENDA

- ▶ **Introduction & update on Interim Measures**
- ▶ ORSA
- ▶ Model Change
 - High level feedback on submissions
 - Guidance
 - Next steps
- ▶ Table discussion
- ▶ Next Steps

SOLVENCY II IMPLEMENTATION

- ▶ Solvency II “start date” delayed by failure of EU policymakers to agree Omnibus II
- ▶ European Insurance and Occupational Pensions Authority (EIOPA) remain concerned about continuing uncertainty over start date of Solvency II
- ▶ Introduction of a number of ‘interim measures’ as a step towards full implementation.
- ▶ Final guidelines were issued in September and these come in to effect on 1 January 2014.
- ▶ The PRA has issued a draft supervisory statement which sets out its expectations of firms in relation to the interim measures.
- ▶ It is expected that this supervisory statement will be finalised prior to the date on which the interim measures come into effect.

INTERIM MEASURES

- ▶ The Interim Measures cover the following four areas:
 - System of governance
 - Forward-looking assessment of the undertaking's own risks based on the principles for the Own Risk and Solvency Assessment
 - Submission of information to NCAs (e.g. PRA/FCA)
 - Pre-Application for internal models
- ▶ There may be some areas where our reviews will have a slightly different emphasis to demonstrate interim measures are being met.
- ▶ Lloyd's will carry out a mapping exercise against the elements of the Solvency II programme to ensure that we are able to demonstrate compliance to the PRA.
- ▶ Further discussion scheduled for the 11 & 12 December Risk Assurance workshops

OCTOBER BOARD ATTESTATIONS RECEIVED AND REVIEW IS ONGOING

- ▶ All agent submissions received by the deadline of 25 October
- ▶ Lloyd's review of agent compliance against principles and full tests and standards is ongoing
 - Account Managers will speak to agents where queries are raised.
- ▶ All agent submissions and ratings will be reviewed by the Standards Assurance Group (SAG) by the end of 2013
 - Agents will receive a formal letter confirming their status
 - The PRA will be informed of Lloyd's view of all Managing Agents
- ▶ Agents should continue to work with Lloyd's to close gaps especially against the principles
- ▶ 2014 ratings will be updated to reflect the Interim Measures

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ORSA REVIEWS RECAP

2012

- ▶ All ORSA reports reviewed as part of FAP reviews in Q1 and individual feedback provided
- ▶ Individual resubmissions/reviews during 2012 as needed

2013

- ▶ Formal submission of all ORSAs in March 2013
- ▶ Reviews completed and formal feedback provided by end Q2
- ▶ Some resubmissions required Q3/Q4 to address specific feedback

2012 FEEDBACK ON FAP SUBMISSIONS SHOWED FURTHER DEVELOPMENT NEEDED...

- ✓ First submission
- ✓ Coverage of regulatory requirements
- ✓ ORSA Policy
- ✓ Short term capital planning
- ✓ Senior Mgt/Board involvement
- ✓ Recognition of progress and work to complete
- ✓ Process will take time to embed
- ✓ Good practice still being defined
- ✗ Basic information not always included
- ✗ Syndicate level information
- ✗ Conclusions from process
- ✗ Stress & Scenario testing
- ✗ Forward looking perspective
- ✗ Assessment of capital
- ✗ Links to risk appetite/monitoring
- ✗ Reliance on underlying documentation

GOOD PROGRESS SINCE 2012...

- ✓ Syndicate level information
- ✓ Senior management and board involvement in process
- ✓ Conclusions from the process
- ✓ Links to risk appetite/monitoring
- ✗ Forward looking assessment
- ✗ Reverse stress testing
- ✗ Solvency assessment

...BUT STILL SOME DEVELOPMENT POINTS

FORWARD LOOKING ASSESSMENT

Observations

- ▶ Majority of ORSA reports included some form of forward looking assessment, usually over the next 3-5 years
- ▶ Projected capital requirements not always included, although detail on planned premium, claims etc was provided
- ▶ Analysis of own funds provided for 2013 year of account only
- ▶ Majority included analysis of projections under stressed conditions (e.g. best/worst case compared to baseline)

Expectations

- ▶ Include both risk and capital profile over the business planning period
- ▶ Key changes in capital requirements over the period in the light of risks faced
- ▶ Details of any material changes in own funds or solvency position
- ▶ Description of contingency plans, where necessary

REVERSE STRESS TESTING

Observations

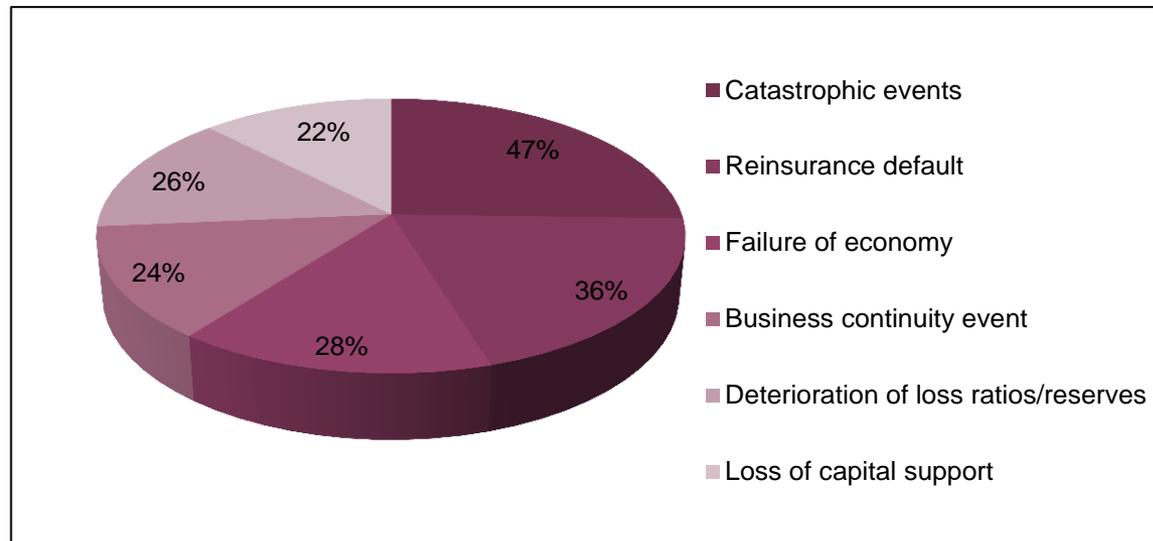
- ▶ Majority of agents provided good level of detail on potential scenarios that could lead to business failure
- ▶ Loss of capital often taken as start point, but other factors that could lead to loss of market confidence not always considered
- ▶ Some agents concluded that the scenarios assessed would not lead to unviability and therefore were not true reverse stress tests

Expectations

- ▶ Assess scenarios and circumstances that would render the business model unviable
- ▶ Start point is the point of unviability, e.g. capital exhaustion, loss of business, reputational impacts of events
- ▶ Conclusions of analysis and planned actions clearly identified

COMMON REVERSE STRESS TESTING SCENARIOS

- ▶ Most scenarios were insurance risk related
- ▶ Many agents also considered scenarios related to other risk categories
- ▶ Six most common scenarios used...



SOLVENCY ASSESSMENT

Observations

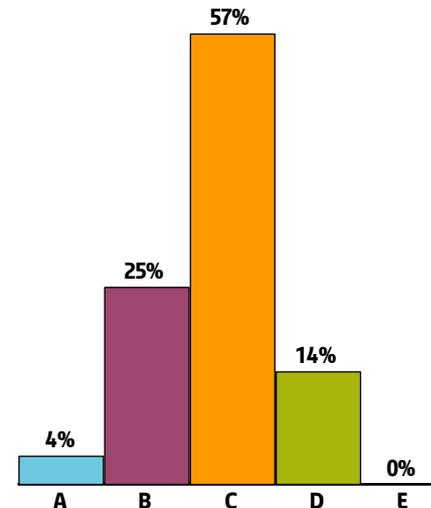
- ▶ Good examples seen showing how capital requirements are/will be met with breakdown of sources of funding
- ▶ Information included on group support where relevant e.g. parent's security rating
- ▶ Some focused on the SCR, with little detail on solvency

Expectations

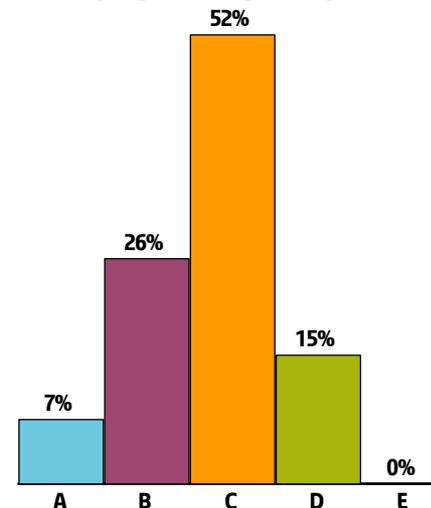
- ▶ Analysis of funds available to meet capital requirements i.e. basic own funds, third party capital etc.
- ▶ Recognise that non-aligned syndicates will have limited transparency over available capital

WHICH AREA OF THE ORSA IS STILL BEING DEVELOPED MOST SIGNIFICANTLY?

- A. Risk Appetite
- B. Stress & Scenario Testing
- C. Forward looking assessment
- D. Senior Management engagement
- E. Something else



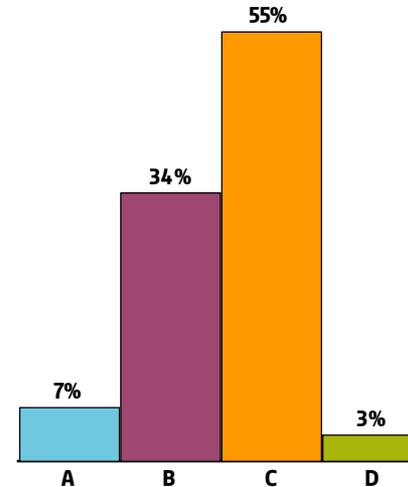
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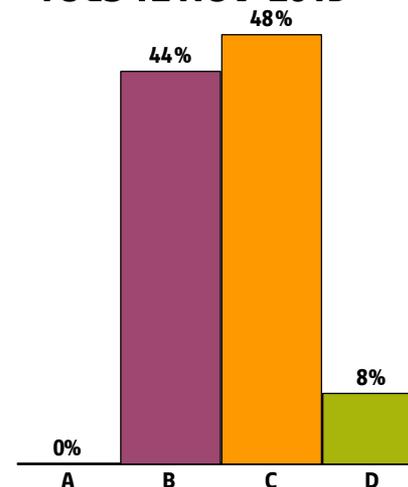
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TO WHAT EXTENT HAS THE ORSA PROCESS BEEN REFINED DURING 2013?

- A. No change
- B. A little, but mainly as planned
- C. Certain areas developed significantly
- D. Fundamental changes this year now that it is operating fully



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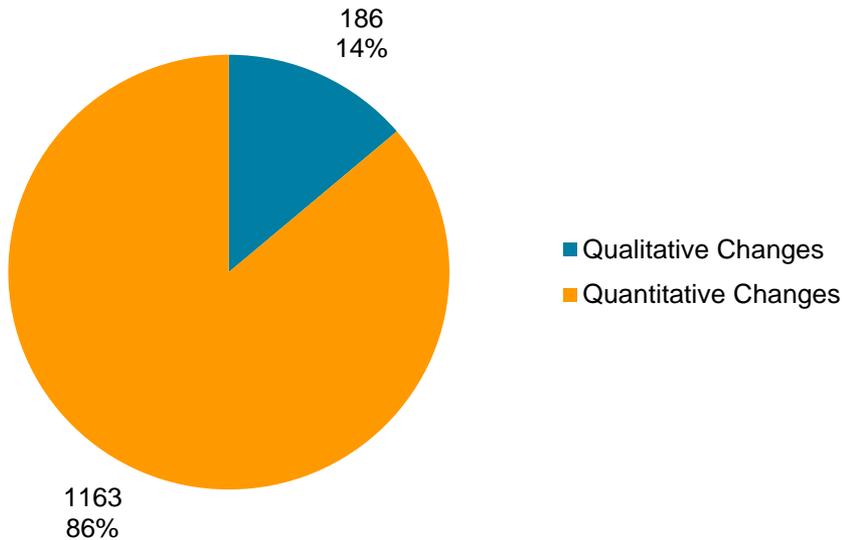
MODEL CHANGE – BACKGROUND

- ▶ The July submission was intended to:
 - Give a market wide view of the types of changes being undertaken and highlight any themes
 - Act as a consultative process to gather data for subsequent guidance to be issued
 - Assist in the SCR review by documenting methodology changes and supporting the analysis of change
 - Provide evidence that syndicate operating models are implemented and effective

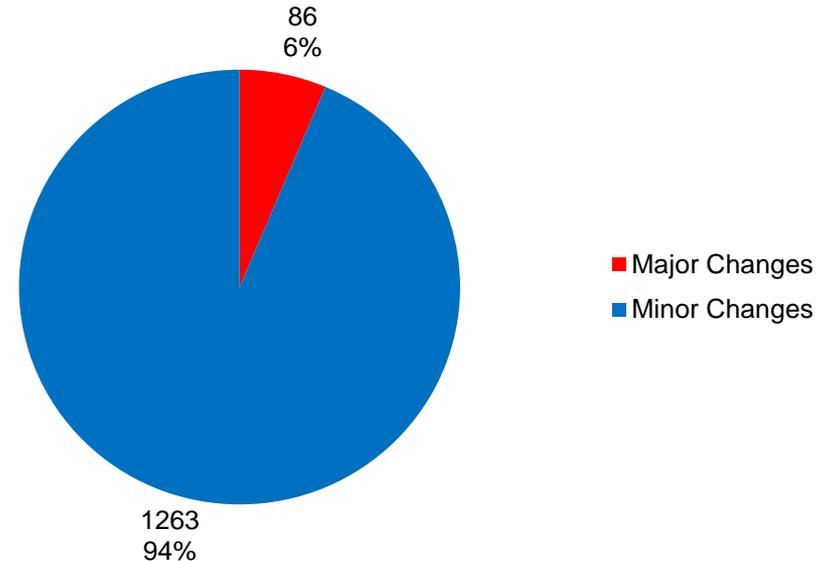
HIGH LEVEL OBSERVATIONS

- ▶ A total of 1354 model changes were reported.
- ▶ On average, 15 model changes were reported per submission.
- ▶ 80% of all submissions reported 15 changes or less.
- ▶ Four submissions contained more than 70 changes.

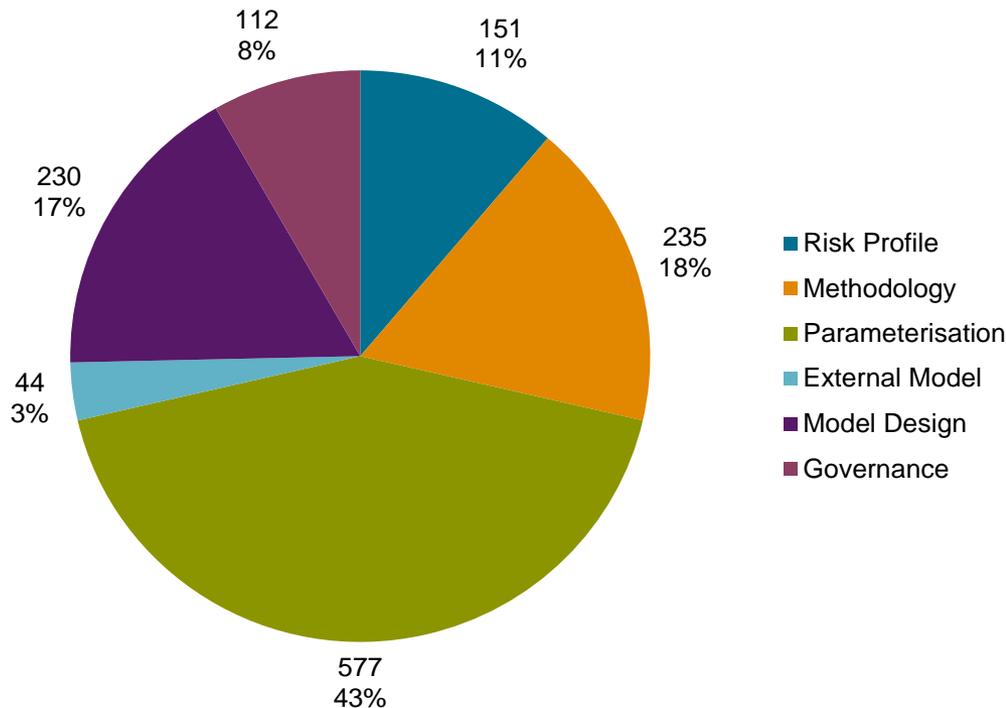
Total Quantitative/Qualitative Changes



Total Major/Minor Changes



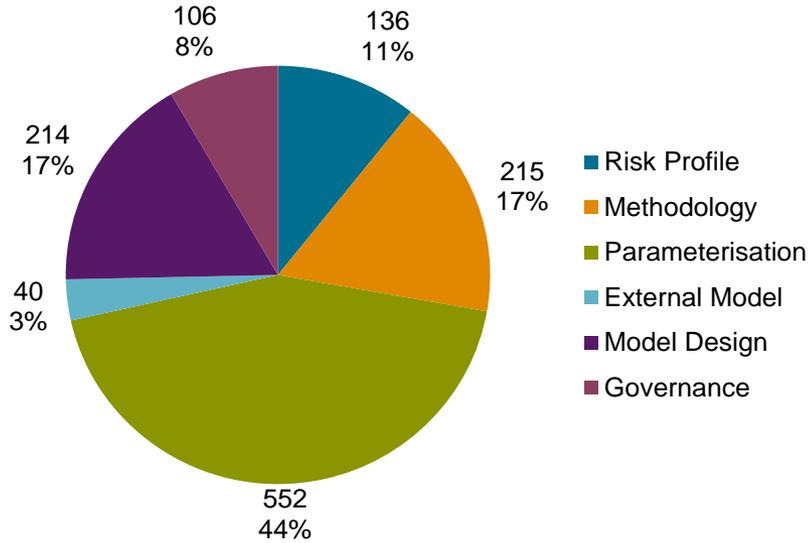
CHANGES BY CLASSIFICATION



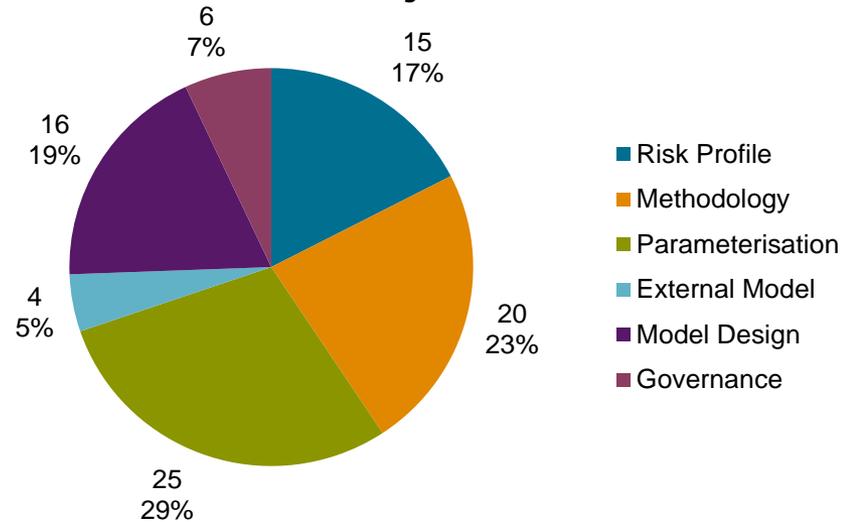
- ▶ Most changes made to models were parameter changes, comprising 43% of all those reported.
- ▶ Only 3% of model changes were alterations to external models, platforms or IT systems.

MINOR & MAJOR CHANGES BY CLASSIFICATION

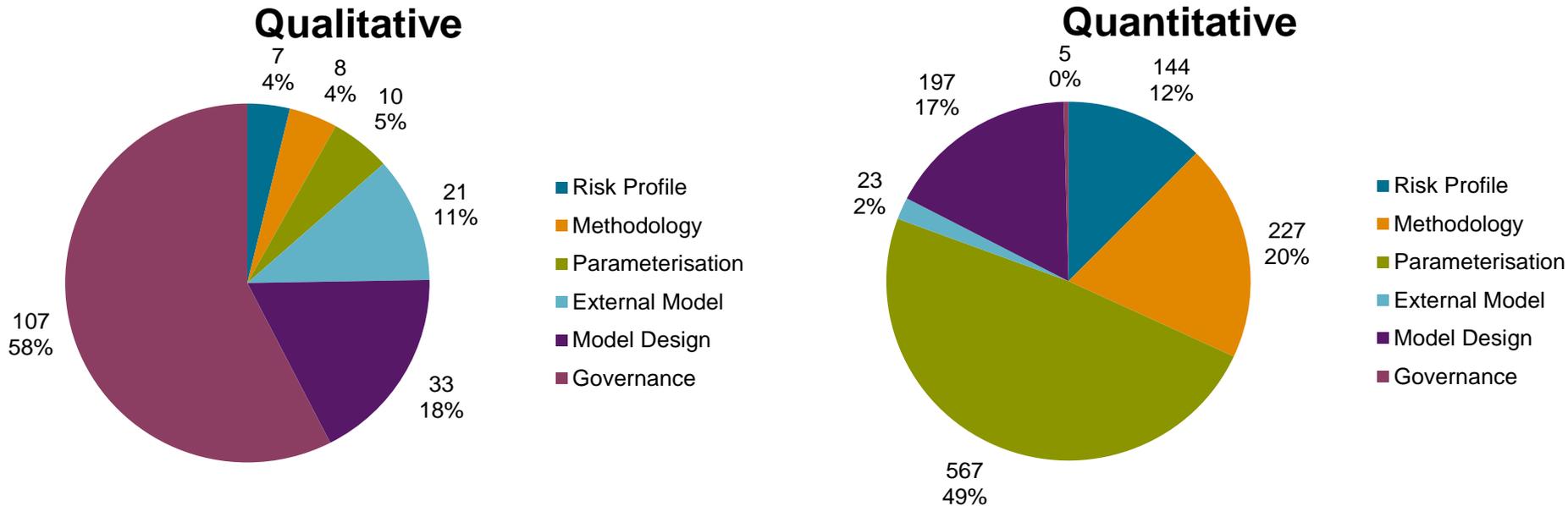
Minor



Major

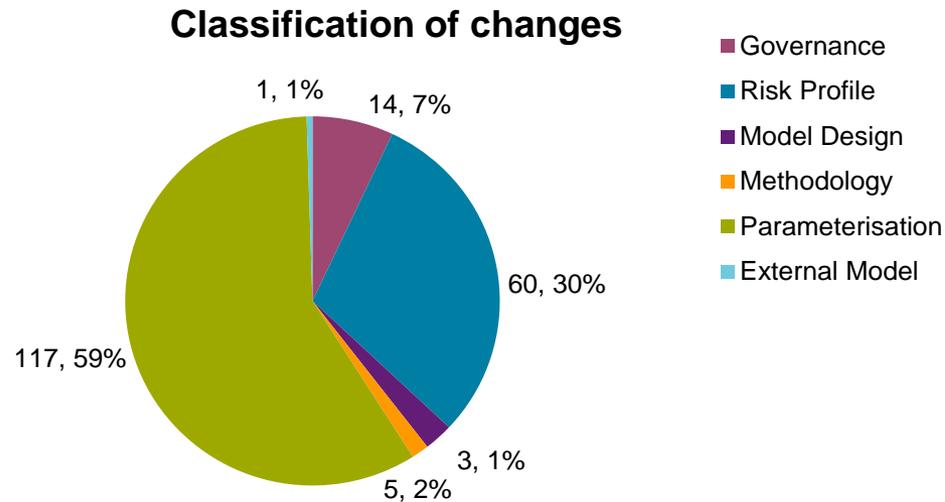


QUALITATIVE VS. QUANTITATIVE CHANGES



- ▶ Governance changes comprised over half of all qualitative model changes made, 5 governance changes were classed as quantitative.
- ▶ Parameter changes constituted almost half of all quantitative changes, 10 (5%) parameterisation changes were classed as qualitative.

CHANGES OUTSIDE OF MODEL CHANGE POLICY



Common changes excluded from Model Change Policies:

1. Changes to the validation process and updates to the Validation Policy
2. Change of membership of Risk Committee
3. Annual re-parameterisation for 2014 SBF
4. Enhanced reserving risk methodology to address a known model limitation
5. Model re-designed and re-built in Remetrica
6. Rescoring of risk register

MAJOR TRIGGER POINT SENSITIVITY

- ▶ 86 changes were classed as major based on agent submissions
- ▶ If we flex the trigger point the following number of major changes would result:

Trigger	Major changes (1 year SCR)
10%	116
15%	84
20%	77

REVIEW OF THE SUBMISSIONS

- ▶ The review of Managing Agent submissions has considered the following:
 - Qualitative analysis e.g. compliance with the policy, further review required, completion of the submission etc.
 - Quantitative analysis e.g. consistency with the risk profile, consistency with the SCR
 - External model changes
- ▶ Lloyd's is developing feedback and guidance to Managing Agents covering the following:
 - Agent specific issues
 - Common themes seen across the market
 - Further guidance where appropriate and defined
- ▶ Meetings will be arranged for Q1 2014 to go through this in more detail

MODEL CHANGE: FEEDBACK AREAS

SUBJECT	OBSERVATIONS
Ultimate versus 1 year SCR	Impact of quantitative model changes on 1 year SCR not always considered.
Policy changes	Not always considered as a major change.
Qualitative changes	Qualitative changes not always recognised as model changes.
Combination of changes following a major change	Variety of approaches: <ul style="list-style-type: none">• All subsequent changes breach change threshold.• Aggregate subsequent minor changes with other minor changes preceding the major change.

MODEL CHANGE: FEEDBACK AREAS

SUBJECT	OBSERVATIONS
Combination of qualitative changes	Little evidence seen to date of consideration of combination of qualitative changes.
Calculating percentage change impact against SCR	Different approaches seen, calculating impact of each model change against: <ul style="list-style-type: none">• last agreed SCR; or• SCR resulting from most recent version of the model
Model change vs. movements in the SCR	Changes in the model change report did not align to the year on year change in SCR.
Model scope extension	Inconsistent approaches to what would be defined as model scope extension

WHAT HAS HAPPENED SINCE THE SUBMISSION? INTERIM MEASURES – PARAMETER UPDATES

- ▶ Explanatory text under Guideline 5 covers parameter updates:

*“Update of parameters can have a significant impact on the model outputs and the SCR in particular and hence it is **generally** within the scope of the model change policy”*

“Some internal models include a great number of parameters which interact together in impacting the outputs of the internal model. Hence it may be more appropriate for the undertaking to consider the impact of changes to some parameters in batch instead of individually.”

“EIOPA recognises that it is not always appropriate to report changes in value of individual parameters.”

“The process for updating the parameters ... is also to be captured in the model change policy.”

INTERIM MEASURES – COMBINATION OF CHANGES

- ▶ Guideline 7 covers combination of changes:

Undertakings should be able to:

- *“evaluate the effect of each change in isolation and the effect of all changes combined on the Solvency Capital Requirement or its individual components”*

and

- *“evaluate such effects in order to prevent individual impacts that offset one another and **the combined impact of multiple changes from being overlooked.**”*

2012 GUIDANCE

TOPICS	PREVIOUS GUIDANCE
Parameter change	<ul style="list-style-type: none">• The regular update of parameters will fall into the scope of a model change.
Risk profile change	<ul style="list-style-type: none">• Need clarity on the definitions of risk profile vs. parameter changes• A change to risk profile will necessitate a change to parameters.
Aggregation	<ul style="list-style-type: none">• Accumulate from last agreed SCR (may be up to a year, depending on interim Major Change approvals)• Aggregate on an absolute, or gross basis (+5% and -5% = 10%)• Aggregate across change types

CURRENT UNDERSTANDING OF REQUIREMENTS

- ▶ Changes to parameters must be included within scope of change policy
- ▶ Process for updating parameters must be within scope of change policy
- ▶ All other categories of change need to be included
- ▶ Approach to aggregation has to ensure that the impact of multiple changes are not overlooked
- ▶ Parameter changes can be appropriately batched together for reporting

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SUGGESTED DISCUSSION TOPICS

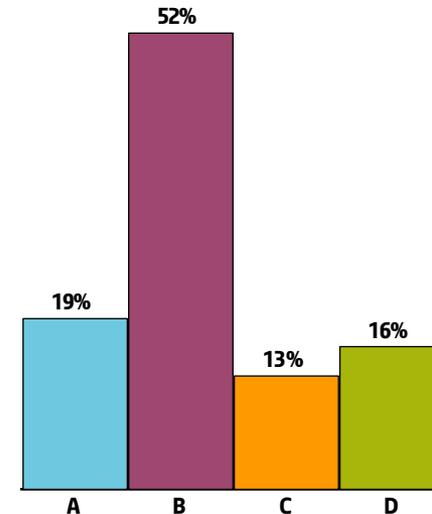
- ▶ How would you define parameter changes to enable a clear distinction between these and other model changes?
 - *To meet the interim measures and develop a workable solution for the market*
 - *Particularly considering if parameter changes should be subject to different aggregation than other changes*
 - *Should parameter changes be treated differently to other changes – can you distinguish between parameter and risk profile changes*
 - *Would it be helpful if Lloyd's issued standard definitions for the types of change including parameterisation*

- ▶ What approach should be adopted for aggregation of minor changes?
 - *Basis needs to meet the interim measures*
 - *Should not drive over frequent aggregation to major change threshold*

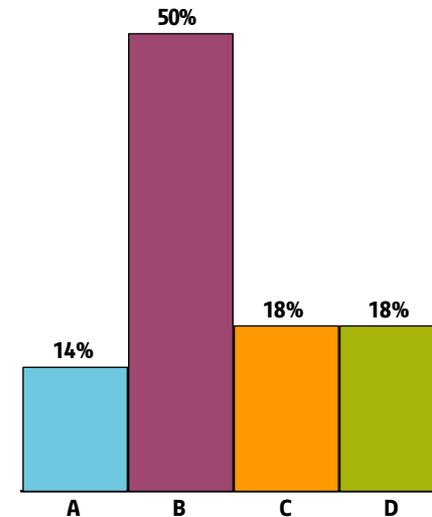
- ▶ What would be an appropriate basis on which to batch parameter changes?
 - *Sufficient granularity to see the impact of the change*
 - *Sufficient clarity on any major changes*

HOW MANY MAJOR CHANGES DO YOU EXPECT TO MAKE IN 2014?

- A. 0 changes
- B. 1-2 changes
- C. 3-4 changes
- D. 5+ changes



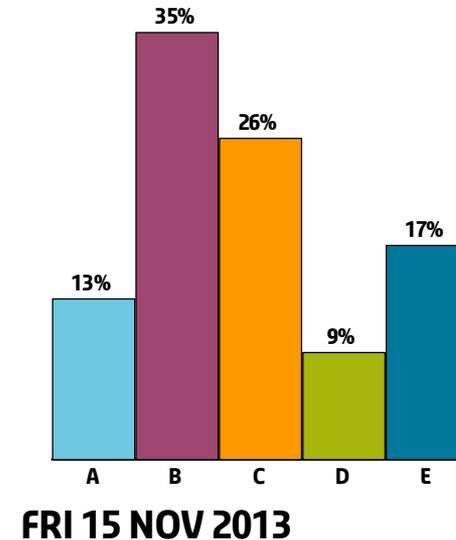
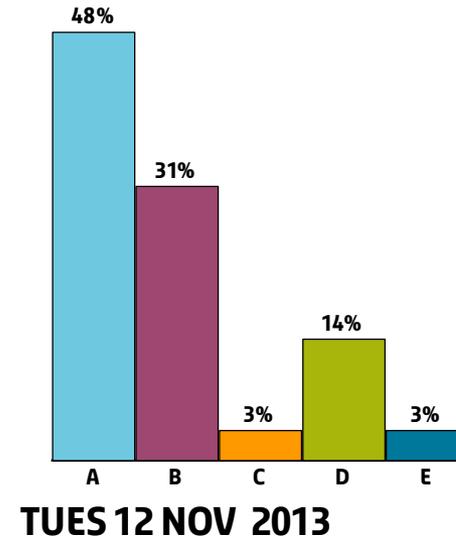
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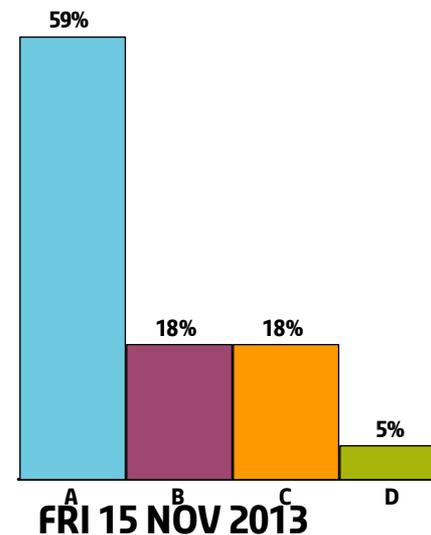
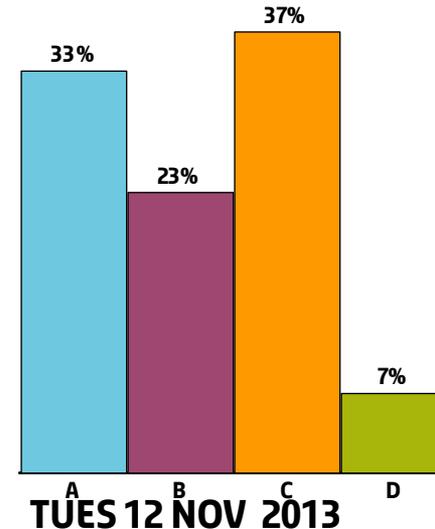
WHICH IS THE KEY CATEGORY WHICH YOU EXPECT THE CHANGES TO OCCUR?

- A. Risk Profile
- B. Methodology
- C. External model
- D. Model design
- E. Governance



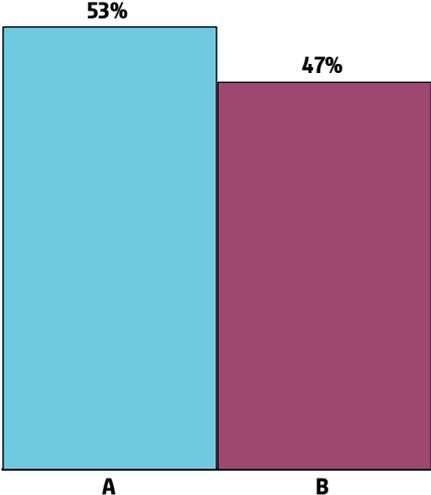
ARE THERE ANY AREAS IN YOUR MODEL CHANGE POLICY WHERE IT WOULD BE USEFUL FOR LLOYD'S TO BE MORE PRESCRIPTIVE?

- A. Definitions
- B. Batching
- C. Aggregation
- D. Other

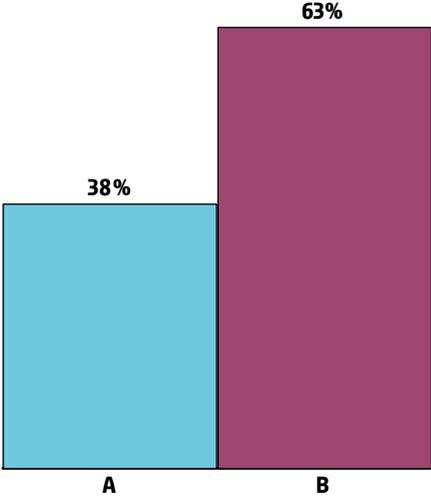


SHOULD LLOYD'S BE MORE OR LESS PRESCRIPTIVE IN OUR REQUIREMENTS IN RELATION TO MODEL CHANGE?

- A. More
- B. Less



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PROPOSED MAJOR MODEL CHANGE REPORTING PROCESS

- ▶ Risk Assurance manager will be contact point and central liaison for model changes
- ▶ Approval of major model changes will be through the Standards Assurance Group (SAG), which meets weekly
- ▶ Lloyd's will use existing processes for notification of major changes where relevant e.g. SBF, SCR submissions, governance notifications
- ▶ In practice Lloyd's would expect to be aware of major changes in advance of any formal submission
- ▶ Likely timings
 - Six months maximum time lapse from initial conversations to approval
 - Formal submission expected mid way through this process
 - Three months maximum elapsed time from formal submission to approval, but Lloyd's would expect to approve many within a month
- ▶ Further definition on large market wide changes required over coming months

FORMAL PROCESS UNLIKELY TO GO LIVE UNTIL 2015, ASSUMING 2016 SOLVENCY II START DATE

NEXT STEPS ON MODEL CHANGE

- ▶ Work through all the feedback we have received today to determine an appropriate approach
- ▶ Consult with the PRA on potential guidance.
- ▶ Consider our 2014 submission requirements, which will be more frequent than 2013.
- ▶ Test the potential implications with a market working group.
- ▶ Further define our reporting requirements for a full dry run in 2015.

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WHAT HAPPENS NEXT?

- ▶ Slides will be made available on lloyds.com after both sessions
- ▶ Next scheduled workshop/briefings:
 - Risk Assurance workshops: 11 & 12 December
- ▶ 2014 Timetable and Guidance to be published
- ▶ Lloyd's use test documentation review is ongoing and interviews being scheduled
- ▶ Lloyd's to carry out a mapping exercise of the interim measures requirements against the elements of the Solvency II programme

