LLOYD'S

# SOLVENCY II OWN RISK AND SOLVENCY ASSESSMENT (ORSA)

## GUIDANCE NOTES

MAY 2012

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# INTRODUCTION

## Background

All managing agents are required to submit both an Own Risk & Solvency Assessment (ORSA) policy at an agent level and an ORSA report(s) covering each syndicate under management.

### Re-submission

Draft ORSA submissions were provided by all managing agents on 16 December 2011. Following feedback as part of the Final Application Pack (FAP) review process, Lloyd's has requested some agents to submit a revised version of these documents. The specific re-submission dates for each managing agent have been agreed via their Solvency II Account Managers. Where gaps have been identified, managing agents should re-submit their ORSA's to Lloyd's by the date agreed. Further details on the 2012 timetable including ORSA submissions are included in Appendix 1.

### ORSA affirmation and link to SBF

In order to enable Lloyd's to link syndicate ORSA's with the Syndicate Business Forecast (SBF) process, managing agents are required to confirm whether the mid to long term plan set out in their December 2011 ORSA, or any subsequent version submitted to address Lloyd's feedback, remains appropriate. This affirmation will form part of the final SBF return in September and should be explicitly indicated in Form 990 under the "add any return comments" section. Refer to market bulletins Y4590 and Y4573 available via the link below for full details on the 2013 SBF timetable and process.

Link to market bulletins

Please contact your Lloyd's Solvency II account manager in the first instance for further information on any of the above.

## Purpose and Scope

This document provides additional guidance to support managing agents in the development of ORSA frameworks with a focus on the ORSA report. This includes areas where Lloyd's has seen development being required or where managing agents have requested further clarification. This guidance supplements individual feedback already provided by Lloyd's to managing agents through the FAP review process and addresses common questions. It supplements ORSA guidance issued in September 2011 available via the link below.

Link to 2011 ORSA guidance

Whilst this guidance focuses on the ORSA report, Lloyd's still expects managing agents to set out the full details of its ORSA processes which adhere to Solvency II requirements within an ORSA policy. Please also refer to the guidance link above.

Whilst the guidance detailed does not intend to prescribe a specific approach to the areas highlighted, there are fundamental principles which Lloyd's would expect to be met within managing agents' ORSA reports. These are identified in the "key principles and Lloyd's minimum expectations" section.

It should be noted that this document provides practical guidance on the ORSA and does not seek to repeat existing Solvency II requirements. Lloyd's "Detailed Guidance Notes for Dry Run Process" issued in March 2010 continue to be valid and managing agents should continue to refer to this for specific requirements on the ORSA (Article 45) and, where relevant, the Use Test (Article 120). This document and any further guidance issued is subject to on-going discussion and change as European Commission (EC), European Insurance and Occupational Pensions Authority (EIOPA) and FSA requirements become clearer.

### Structure of this document

This document contains the following sections and supporting appendices:

- **Key principles and Lloyd's minimum expectations**

  Lists the core requirements which all managing agents are expected to meet.

- **Detailed guidance**

  Provides further detailed guidance on elements of the ORSA which may require the most development or where further clarification has been requested by managing agents. This is based upon Lloyd's view of good practice across the Lloyd's market and can be adapted by each managing agent in a suitable manner that is appropriate to their business. The detailed sections are listed below:

  - Risk profile and appetite
  - Assessment of capital
  - Stress and scenario testing
  - Forward looking assessment
  - Additional areas

Each section is structured in a tabular format with the following headings:

| TABLE HEADING | DESCRIPTION |
| --- | --- |
| **Common issues identified** | Describes the features of ORSA reports / policies as observed by Lloyd's in the 16th December 2011 submission; Also areas where agents have requested further clarification. |
| **Lloyd's expectations** | Sets out what Lloyd's would expect to see from an agent's ORSA report in order to meet Solvency II requirements. |
| **Examples of observed gaps** | Articulates what would be unlikely to meet the requirements for the ORSA submission. |
| **Lloyd's approach** | Provides an overview of the approach used by Lloyd's in the production of the Society ORSA report. For details of this framework please refer to the previous ORSA guidance issued in September 2011 on Lloyds.com.<br>**NB** This is provided to managing agents for reference only and is not a prescribed approach. |

# KEY PRINCIPLES AND LLOYD'S MINIMUM EXPECTATIONS

1. **Syndicate focus** *(refer to pages 9 and 10)*

   Managing agents must provide sufficiently detailed risk and capital information about all syndicates under management so that clear conclusions and decision making can be demonstrated specific to each syndicate.

2. **Clear conclusions and management actions** *(refer to page 9)*

   The report should provide a summary of the key conclusions drawn from underlying processes and not solely duplicate existing documentation in place. The ORSA report should also clearly outline mitigating actions currently in place or planned.

3. **Detailed capital assessment** *(refer to page 10)*

   The capital assessment must clearly set out each syndicate's capital requirements including an explanation of the difference between regulatory (SCR) and economic capital assessments. The report should state an "own" assessment of economic capital required (which must be at least equal to the 1 year Economic Capital Assessment or "ECA" for member capital setting) for each syndicate with supporting rationale.

4. **Stressed risk and capital profile** *(refer to pages 11 and 12)*

   The ORSA report should clearly detail the results of any quantitative and qualitative analysis conducted of potential "shocks" or risks the business may face, both over the one-year and longer-term horizon. This assessment should include anticipated future risks along with an associated impact on capital assessments and performance. This assessment does not require managing agents to have a "multiyear" internal model.

5. **Board approval** *(refer to page 12)*

   All ORSA reports and any major changes to policies should be Board approved before being submitted to Lloyd's and should include clear "as at" dates.

   The Board should receive and use the same version of the report that is submitted to Lloyd's or any other supervisor.

6. **Clear use of the ORSA in management decision making**

   Agents may consider asking key questions to their Board in order to help facilitate use of the ORSA in decision making. The following questions were used to frame the Society ORSA report and were posed to the Franchise Board:

   - Does the report cover the key risk issues and capital assessments as you see them?
   - How comfortable are you with the risk you are taking on? Is it within your overall appetite?
   - What, if any, additional management actions should be considered?
   - How comfortable are you with the level of capital held?
   - How comfortable are you that you are well prepared to withstand shocks or risks to which you may be exposed to over the next 3-5 years?

7. **Format and length**

   The ORSA report should be a sufficiently concise document, providing details of the overall result of ORSA processes and reference to supporting information. The document should be of a length that is appropriate for use by the managing agent's Board and senior management.

# DETAILED GUIDANCE

## Risk Profile and Appetite

| COMMON ISSUES IDENTIFIED | LLOYD'S EXPECTATION | EXAMPLES OF OBSERVED GAPS | LLOYD'S APPROACH |
|---|---|---|---|
| **Risk Profile vs. Appetite**<br>1. Lack of clarity over key risks or status against appetite | • Summary of current material (quantified and non-quantified) risk exposures at syndicate level reported to the Board at a sufficient level so that management can take appropriate action<br>• Emphasis placed upon those key risk exposures approaching or outside appetite at a syndicate level<br>• Details of relevant changes in key risk exposures and appetite experienced throughout the year reported to the Board or senior management | • No syndicate-specific information on risk profile and appetite<br>• Unclear identification of key risks faced and changes to risk profile encountered throughout the period covering the ORSA report<br>• No details of the risk appetite metrics put in place at a syndicate level to monitor the risk profile | • Lloyd's Society ORSA report summarises the key risk exposures along with supporting risk appetite metrics already reported to the Executive Risk Committee (ERC) and Franchise Board (FB).<br>• Details of the full risk ratings and risk appetite metrics provided in the appendix |
| **Mitigating Actions**<br>2. Lack of detail around the mitigating actions put in place for risks identified | • Details of mitigating actions in place where required for all key risks highlighted (including use of reinsurance)<br>• Reference to the controls in place to manage risk | • Vague or no description of the specific mitigating actions taken an key risks<br>• No reference to the specific controls in place in order to mitigate key risks | • Where a key risk is detailed, an associated management action is clearly highlighted. This is detailed at a high level in the executive summary and then in further detail in the main body of the report<br>• Actions tracked in quarterly monitoring |
| **Non-Quantifiable Risks**<br>3. No detail of the assessment of non-quantifiable risks | • Consideration within the ORSA of all risks with the syndicate's risk universe | • Reporting on risks which only support the calculation of the SCR | • All risks (quantifiable and non-quantifiable) are treated exactly the same, i.e. description of the risk and mitigating actions put in place. Full risk appetite metrics detailed in appendix |

## Assessment of Capital

<table>
<tr><th>COMMON ISSUES IDENTIFIED</th><th>LLOYD'S EXPECTATION</th><th>EXAMPLES OF OBSERVED GAPS</th><th>LLOYD'S APPROACH</th></tr>
<tr><td><u>Economic Capital</u><br>1. "Own view" of economic capital not provided or with insufficient rationale</td><td>• "Own" assessment of economic capital required (which must be at least equal to the 1 year ECA) for each syndicate with supporting rationale</td><td>• No capital results presented at a syndicate level<br>• No assessment of economic capital or no supporting rationale of result<br>• Conclusion of "SCR to ultimate + 35%" result without rationale</td><td rowspan="3">• Lloyd's Society ORSA report clearly sets out the capital requirements from both a member and central perspective<br>• Details of a target minimum size of the Lloyd's Central Fund as provided along with details of target ratings<br>• Rationale of why the level of capital held was deemed appropriate to meet strategic objectives and risks faced with reference to historical experience<br>• Range of capital metrics included:<br>○ Breakdown of SCR by risk type<br>○ An assessment of the amount capital held vs. total available assets<br>○ An assessment of the quality of capital</td></tr>
<tr><td><u>SCR Analysis</u><br>2. SCR "one year" and "ultimate" results not referenced<br>3. No comparison to standard formula result<br>4. Insufficient supporting analysis of the SCR and ECA results</td><td>• For each syndicate:<br>- The SCR 'one year' result from the internal model<br>- The SCR to 'ultimate' result from the internal model<br>- The standard formula result comparing the above[1]<br>• Supporting analysis e.g. breakdown by risk type and key sensitivities of the SCR and ECA results</td><td>• Only one of the defined SCR measures presented<br>• No analysis of SCR and ECA (sensitivity or breakdown) result</td></tr>
<tr><td><u>Assessment of Own Funds</u><br>5. Insufficient detail in the analysis of own funds</td><td>• Analysis of capital results in relation to own funds (assets) held[2]<br>• Analysis of the quality of capital (tiering requirements)<br>• Assessment of the ability to raise capital if required</td><td>• No comparative analysis of the SCR and economic capital results to own funds<br>• No discussion of capital held or the make up or quality of capital<br>• Stating that additional capital can be raised without detail</td></tr>
</table>

[1] Extensive analysis not required on the standard formula comparison to the SCR. Only a high level justification of the main differences

[2] Lloyd's recognises the nature and make up of 'available funds' will differ considerably according to the structure of individual syndicates (for example agents may have limited transparency over available capital where this is provided by third party capital). Therefore we may expect agents to reference this within the ORSA report and note potential actions/contingency plans where available capital is likely to be insufficient to support future business plans. We would not, however, expect this to change the role of agents with respect to assessing solvency

## Stress and Scenario Testing

<table>
<tr><th>COMMON ISSUES IDENTIFIED</th><th>LLOYD'S EXPECTATION</th><th>EXAMPLES OF OBSERVED GAPS</th><th>LLOYD'S APPROACH</th></tr>
<tr><td><u>Conclusions on tests</u><br>1. Unclear or no conclusions on the results of stress and scenario tests</td><td>• Clear conclusions on the results of the key stresses performed including a range of quantified and non-quantified impacts e.g. impact on reputation, liquidity etc<br>• Assessment of capital adequacy following the stress<br>• Details of contingency plans or mitigating actions if required</td><td>• Providing the results of tests without making conclusions on risk, capital and solvency impact<br>• No detail of contingency plans and management actions overlooked</td><td rowspan="2">• Stress tests performed focus on key risk exposures identified and are presented as a summary of the information in which the Franchise Board had already seen throughout the year. An example includes the Eurozone threat<br>• Stresses evaluate the potential impact on capital requirements and value of own funds<br>• Description of management actions taken as a result of performing stress tests</td></tr>
<tr><td><u>Comprehensive tests</u><br>2. Limited range of tests in relation to the business plan</td><td>• Results of a full range of tests covering key risks<br>• Combined test scenarios e.g. a severe catastrophe event causing liquidity strain etc<br>• A range of quantified and non-quantified results of reverse stress tests including consideration to the impacts to the business</td><td>• No or limited stress testing performed<br>• No link or reference to the business plan</td></tr>
</table>

## Forward Looking Assessment

| COMMON ISSUES IDENTIFIED | LLOYD'S EXPECTATION | EXAMPLES OF OBSERVED GAPS | LLOYD'S APPROACH |
|---|---|---|---|
| 1. Limited focus on forward looking assessment of risk and capital<br>2. Insufficient analysis on expected changes in business profile | • A meaningful forward-looking assessment of risk and capital[3], for example over the next 3–5 years. This assessment should include:<br>**Risk Profile**<br>• Key changes in risk profile over the period with reference to risk appetite; where relevant, provide risk profile on a gross and net basis (or specify which basis is shown)<br>• Assessment of any additional emerging risks and the impact on risk appetite in light of strategy / business plans<br>• Description of management actions taken or contingency plans required to mitigate anticipated risks<br>**Capital Profile**<br>• Key changes in capital requirements over the period in light of the risks faced (as identified above)<br>• Details of any material changes in own funds or solvency position<br>• Description of contingency plans (e.g. capital raising) where | • Not providing any forward looking assessment of the risk and capital profile<br>• Stating that capital will be adequate over the next 3-5 years without rationale<br>• Stating that risks will be operating within appetite without rationale<br>• Forward looking assessments which are inconsistent with business plans | • Qualitative and quantitative assessment of the key risks identified over the next 3 years to Lloyd's and the market e.g. management view of the risk of the "insurance cycle" over future years<br>• Details of the anticipated movement within key risks along with planned management actions<br>• Use of Lloyd's Internal Model (LIM) to assess capital requirement over future period:<br>  ○ Stress test approach used by varying assumptions used in 1-year calculation<br>• Assessment of available assets under different scenarios (e.g. economic, insurance cycle etc) |

[3] Lloyd's recognises the challenge to perform a detailed forward looking assessment of capital and solvency given certain group structures or where syndicates are backed by a third party provider. In these circumstances, Lloyd's expects managing agents to provide clear description of how business plans may change and the impact this likely to have on capital and an assessment of how this capital is to be raised (referencing contingency plans where appropriate)

| COMMON ISSUES IDENTIFIED | LLOYD'S EXPECTATION | EXAMPLES OF OBSERVED GAPS | LLOYD'S APPROACH |
|---|---|---|---|
| | necessary<br>• Commentary on what, if any capital diversification benefit has been assumed for changes from the current one year plan to the forward-looking (e.g. 3-5 year) assessment<br>• Furthermore, details of internal model specific issues e.g. deviation from assumptions and the relationship between quantified and non-quantified risks<br>**Notes:**<br>1. The forward looking assessment does not require managing agents to have a "multiyear" internal model.<br>2. Agents are not expected to produce a detailed forecast of their SBF for the forward looking assessment only evidence that they have considered their future risk and capital profile in a robust way | | |

## Guidance on Other Areas

| COMMON ISSUES IDENTIFIED | LLOYD'S EXPECTATION | WHAT'S NOT SUFFICIENT | LLOYD'S APPROACH |
|---|---|---|---|
| **Roles and responsibilities**<br>1. Lack of clarity around the roles and responsibilities of the Board, committees and senior management in relation to the ORSA and its supporting processes | • Board approval of policy and report<br>• Details of overall ownership of the ORSA and its processes including details of delegated responsibilities<br>• Clear alignment between ORSA policy and other governance documentation e.g. committee terms of reference | • Governance around the ORSA not clear or documented<br>• General discussion on roles and responsibilities which is not aligned to committee terms of reference etc<br>• Accountability, oversight and challenge processes are not detailed | • Lloyd's Society ORSA policy articulates the ownership of the ORSA along with the supporting governance framework including roles and responsibilities<br>• A organisational chart is pictured along with a table which describes the roles and responsibility of each committee, area or team within the ORSA process |
| **Technical provisions**<br>2. No information on technical provisions | • Confirmation of the continued compliance and quantification of technical provisions<br>• Details of the link to the Actuarial Function report which will contain more information around the risks in this regard | • Not confirming that there are processes in place which adhere to the new requirements under Solvency II | • Lloyd's Society ORSA policy details a short section on technical provisions which confirms to the continued compliance to the calculation of technical provisions |
| **Data quality**<br>3. Unclear information about the data used | • Confirmation that data used within the ORSA from the internal model has been appropriately validated / audited and meets the required standards<br>• Confirmation that data not from the internal model used within the ORSA meets internal data standards (as appropriate)<br>• Details of "as at" dates of the data used and any limitations<br>• Inclusion or references to data management policies put in place | • Providing no details relating to the processes in place to ensure the data used within the ORSA is complete, accurate or reliable | • Lloyd's Society ORSA policy includes a short section on data sources which outlines the process for overall data quality within each ORSA process<br>• The section is at a high level and makes reference to the Lloyd's Data Quality Management policy |

## ORSA Contact Details

### Risk Management

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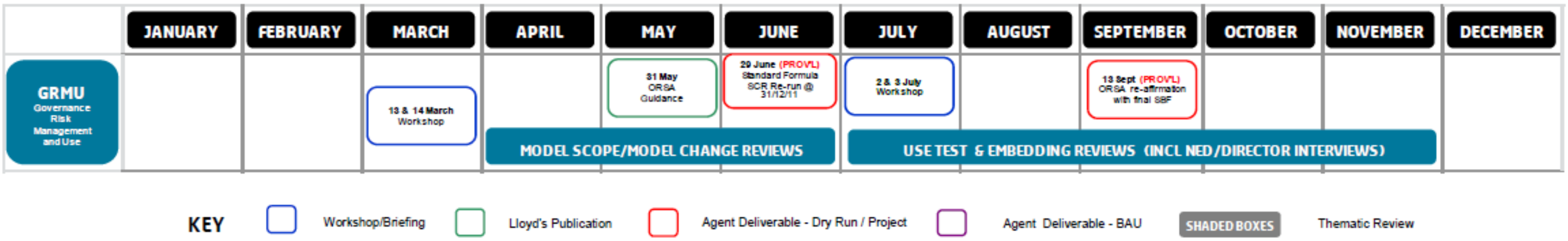
# APPENDICES

# APPENDIX 1: SUBMISSION TIME TABLE

## Overall 2012 Governance, Risk Management and Use Timetable

Published on Lloyds.com in February 2012. Refer to document in link for full details.




| Workshop/Briefing | Date: | Topics to be covered: |
|---|---|---|
| **Workshop #1** | 13 & 14 March 2012 | Further detail and discussion on model scope and model change reviews, and upcoming thematic work. |
| **Workshop #2** | 2 & 3 July 2012 | Further detail on ORSA guidance and use test & embedding reviews. |

| Lloyd's Publication | Date: | Content: |
|---|---|---|
| **ORSA Guidance** | 31 May 2012 | Lloyd's will issue updated ORSA guidance following review of ORSAs submitted in December 2011. |

| Agent Deliverable | Date: | Project or BAU Deliverable? | Description: |
|---|---|---|---|
| **ORSA re-affirmation with final SBF (Provisional)** | 13 September 2012 | Project | Lloyd's will require all Agents to affirm that mid/long term business strategy set out in 2011 ORSA remains valid or to provide an update where this has changed. |

## ORSA Specific Dates

### 30 June 2012

All gaps identified by agent or from FAP review process to be closed, to include ORSA re-submissions where requested.

### 13 September 2012

Agents are required to affirm that the mid to long term plan set out in in their December 2011 ORSA or any subsequent version submitted to address Lloyd's feedback remains appropriate. If the assumptions set out in the ORSA submitted to Lloyd's no longer remain appropriate, managing agents will need to provide an updated set of assumptions.

The timetable for 2013 ORSA submissions is still under development.

# APPENDIX 2: ORSA FAQ'S

(Published on Lloyds.com)

| Question Raised | Lloyd's response |
|---|---|
| The ORSA 10 score requires Board sign off. Lloyd's has advised that the ORSA does not require specific Board approval (but does require Board involvement) for the FAP, will this remain or be removed from the 10 score requirements? | Lloyd's did not require specific Board approval of the ORSA for FAP submission in December 2011. However, we would expect evidence of Board involvement in the ORSA process and the Board to be signing off on a version of the ORSA in Q1 2012, hence the score of 10 for this period. Lloyd's would not necessarily expect to have sight of this but would expect agents to have gone through this process. |
| As the ORSA is not part of the internal model submission why is there such a push on it from Lloyd's? | Lloyd's requires syndicate ORSAs to feed into our overall risk management approach and demonstration of use. As such, syndicate ORSAs are a key input into the Lloyd's internal model submission. |
| Instead of re-affirming the ORSA in September/October can agents opt to provide a new/updated ORSA? | Yes. Managing agents may provide an updated ORSA if they wish to do so. |
| How does Lloyd's differentiate between the level of detail provided in an ORSA and its usefulness to the Board when considering an overall assessment? | We have focused on assessing ORSAs against the regulatory requirements as part of the FAP review. As part of this, consideration has been given to its usefulness as a management/Board document in line with meeting the requirements. |
| What approach should agents take to independent review of ORSA given it fell out of the level 2 guidance? | Despite there being no specific guidance on independent review in the latest Level 2 Guidance; we would expect Internal Audit to still have an interest in such a key process. Whilst there is no specific requirement to include detail of this in the ORSA report we would expect the ORSA to fall within the scope of the assurance process of any 3 lines of defence model. |