# ORSA & MODEL CHANGE

## MARKET BRIEFING

## 8 & 10 JULY 2015

# AGENDA

► **General Update**

► **Feedback from ORSA Review**

► **Model Change**

► **Discussion**

► **Validation Minimum Standards**

► **Next steps**

# GENERAL UPDATE

► Lloyd's IMAP has been submitted

   – We expect ongoing discussions with the PRA but do not expect a formal decision until end of 2015

► Discussions continue with the PRA over syndicate readiness

► Failure to obtain model approval remains a key risk as outlined in the Lloyd's Annual Report

   – Contingency plan is in place

   – Would be implemented as an interim measure pending a revision to the LIM

# GENERAL UPDATE

► Some new processes for us (and you) this year:

– Model Change

> Regular reporting of all model changes

> Pre-approvals of major model changes

– New Lloyd's Minimum Standards

> Some old: eg Underwriting, Claims, Governance

> Some new: eg Operating at Lloyd's, Reserving

> Regular Self Assessment submissions and reviews

# GENERAL UPDATE – PILLAR 3

► For Lloyd's to be able to meet its Pillar 3 requirements, all agents must be ready by end 2015

► Thematic review of agents' readiness in Q3 2015, taking into account:

 – Compliance so far in dry runs and interim reporting

 – Review of agents' Pillar 3 status reports submitted on 30 June 2015

► Continual assessment of agents' Solvency II compliance

 – Significant concerns over Pillar 3 may result in agent being downgraded from green to red

 – Consideration of prudential measures by Lloyd's

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# APPROACH FOR 2015

- ORSA reports are now considered to be an embedded part of agents' internal reporting processes.

- Review emphasis shifted from the SII Tests & Standards to focus on the information included.

- Relevant issues or concerns feed into the Risk Management & Governance Oversight Team's planned agent interactions for the remainder of 2015 and Q1 2016.

- Follow-up sessions held with all agents to outline findings. Findings will be split across:

  - Discussions

  - Actions Required

  - Recommendations

# HIGH LEVEL FINDINGS

- Report formats have not changed significantly.

- Content of reports continues to develop.

- Reports contain good level of detail on strategic activity.

- Reports evidence continued development of Scenario, Stress and Reverse Stress Testing.

- Clear conclusions.

# HIGH LEVEL FINDINGS

► Common Discussion Topics

 – Breaches of risk appetite, tolerance or control weaknesses.

 – Board discussion of the report.

 – Review of the report / ORSA process.

 – Emerging risks – processes and risks considered.

 – Approach to Stress, Scenario and Reverse Stress Testing.

 – <u>Actions Required</u> and <u>Recommendations</u> more aligned to specific tests and standards requirements as per previous reviews.

# WHAT WILL FOLLOW UP LOOK LIKE?

► Discussion topics

- – Could feed into specific Risk Management or Governance review work

- – Follow up meetings on specific topics

- – Points already covered sufficiently through ORSA discussion

► Action required

- – Specific action to be taken by the agent by end August 2015

► Recommendations

- – Understanding needed on the steps agents are taking on particular issues

# ADDITIONAL TOPICS RAISED THROUGH MEETINGS

► Length of the ORSA report

► Duplication with other reporting

► Consistency with PRA feedback

► Requirement for an ORSA 'Record'

► Reverse Stress Testing – particularly for agents which are part of larger Groups

► Stressing and developing the forward looking assessment in line with business strategy

► Extent of circulation of the ORSA report

# CONSISTENCY WITH PRA

► PRA and Lloyd's consistent in terms of feedback themes (based on PRA public letter issued in June):

  – Board sign-off and embedding

  – Links to Business Strategy

  – Identification of risks

  – Capital and Solvency

  – Stress Testing

► We will continue to share our views and findings

► Minimum Standards not designed to replicate all requirements

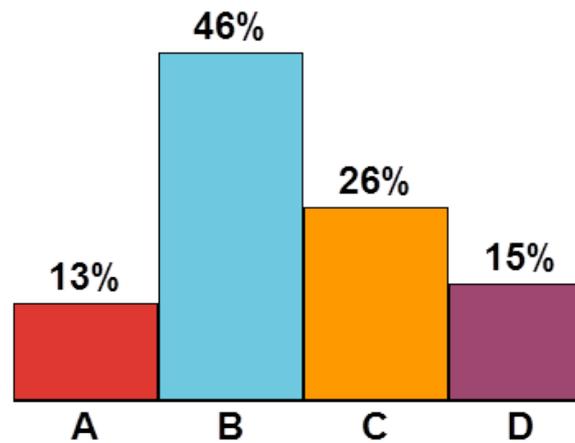► Minimum Standards will be revisited on publication of final Solvency II requirements

# HOW MUCH REFINEMENT HAS THE ORSA PROCESS BEEN THROUGH IN 2014/15?

A.   No change

B.   A little through BAU

C.   Certain areas developed significantly

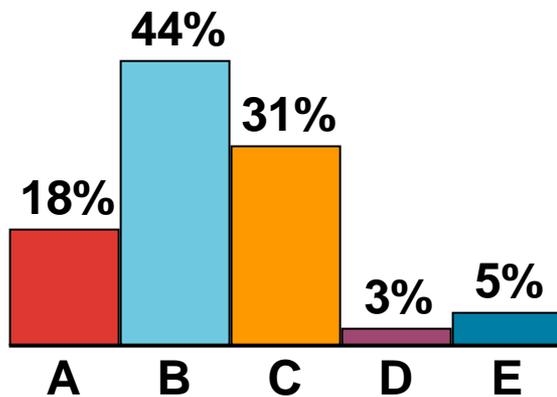D.   Fundamental changes across the document
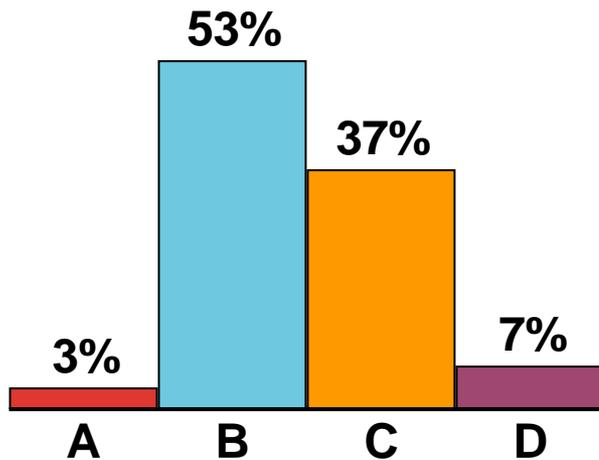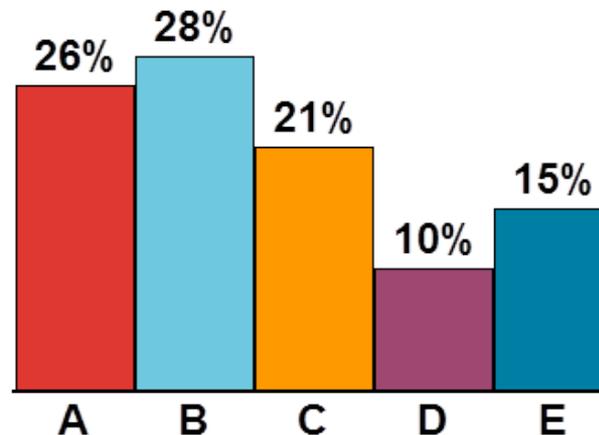
Results from 8 July

Results from 10 July

# WHICH AREA OF THE ORSA IS BEING CHANGED THE MOST?

A. Risk Profile and Appetite

B. Stress & Scenario Testing (including Reverse Stress Testing)

C. Forward looking assessment
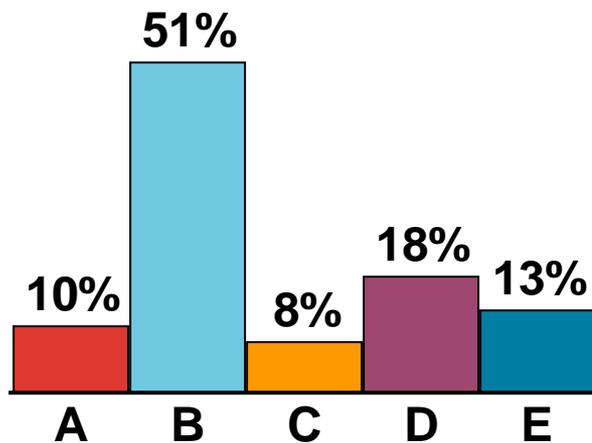
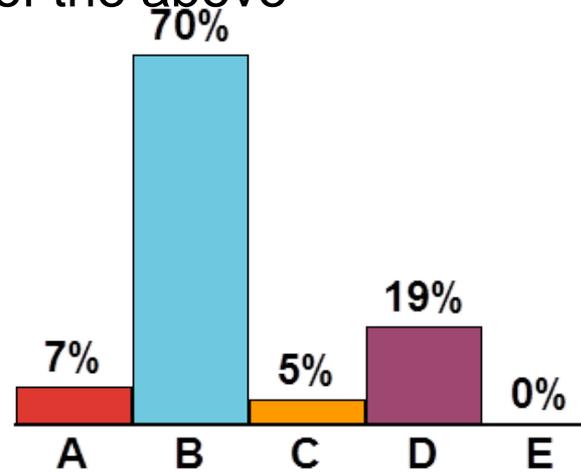D. Capital analysis

E. Something else



Results from 8 July

Results from 9 July

# HOW EXTENSIVELY ACROSS THE ORGANISATION DO YOU SHARE YOUR ORSA REPORT?

A.  Board only

B.  Board and Senior Management

C.  All Committees

D.  It is available to everyone

E.  None of or a combination of the above

Results from 8 July

Results from 10 July

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# SIMPLE IN THEORY...

► Significant market engagement through 2012 to 2014 in relation to model change policies and how the process should work at Lloyd's.

► General consensus achieved by end of 2014 in terms of approaches to Model Change policies.

► In 2015 Lloyd's is operating a dry run of its model change approval process in readiness for a Solvency II live environment in 2016

  – Pre-approval of major model changes by SAG ahead of implementation by the managing agent

  – Quarterly reporting of all model changes undertaken, both major and minor

  – Major model changes in July or September reviewed by SAG, with capital impact reviewed by CPG

# ......NOT SO EASY IN PRACTICE

## Positives

- ✓ Major changes now being submitted for pre-approval

- ✓ Quarterly submissions a useful checkpoint and information source

- ✓ Profile of major changes risen significantly

- ✓ SAG review and approval beneficial and increasing ongoing knowledge of agent models

- ✓ Clear alignment between consideration of major changes and overall Solvency II considerations and ratings

## Development

- ✗ Clarity and guidance on how SCR process will integrate with Model Change

- ✗ Treatment of aggregation of minor changes

- ✗ Lloyd's review process & formal communications

- ✗ Treatment of data changes

LLOYD'S

# SO FAR THIS YEAR*...

► Statistics on Major Model Change requests received:

– We received Major Model Changes from 17 Managing Agents

– 48 Major Model Change requests submitted in total

– 40 Quantitative Major Model Changes

– 8 Qualitative Major Model Changes

– 11 Major Model Changes were due to a Combination of Minor Changes.

– 12 Major Model Changes have been approved by SAG

– 6 Major Model Changes have been deferred to the next SCR review

► **39** Major changes submitted as part of July LCR submission

*Statistics since beginning of 'live' process at the start of 2015

# JULY – SEPT CPG & SAG PROCESS FOR MODEL CHANGE

► 2 July submission needed to include SCR, Quarterly Model Change report and any major model change requests together with supporting documentation.

► Review of the model change will be undertaken as part of the review of the draft SCR.

► SAG meetings take place after CPG meetings – to discuss issues arising from CPG review of SCRs….

► …and may or may not be ready to approve the model change request…so will then need to come back to SAG for approval.

► SAG consideration of model changes are subject to:

   – Review of the adequacy of the model and any validation that has been completed on the model change

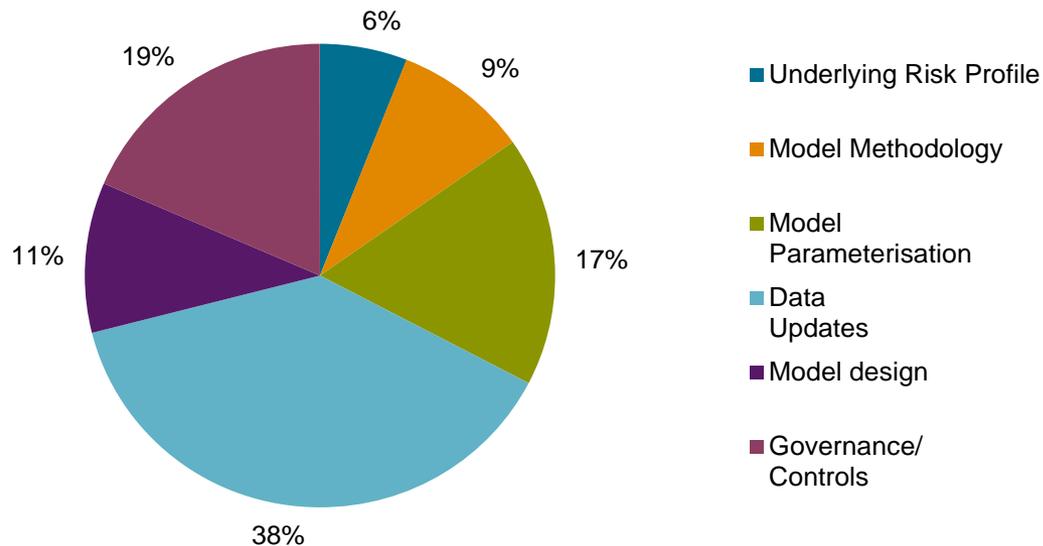   – CPG approval of final capital number
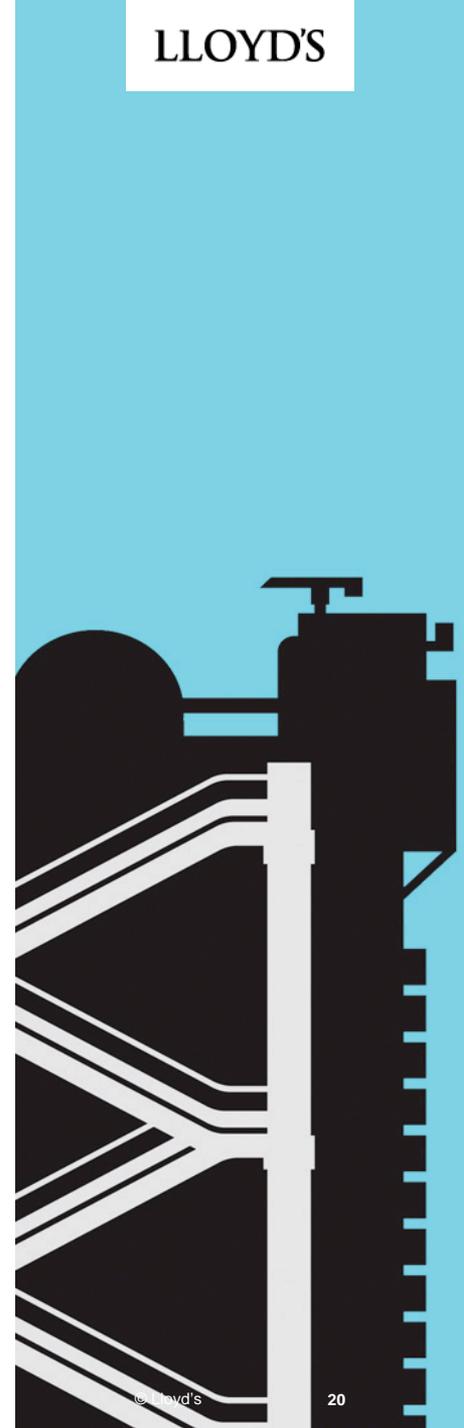
# HIGH LEVEL OBSERVATIONS ON QUARTERLY SUBMISSION*

► A total of 918 model changes were reported

► On average 10 model changes were reported per syndicate

► The maximum number of changes reported was 95

► 723 changes were within scope of model change policies

► 195 changes were out of scope of agent model change policies i.e. data

*Based on March 2015 submission covering period from SCR agreement for 2015 YOA
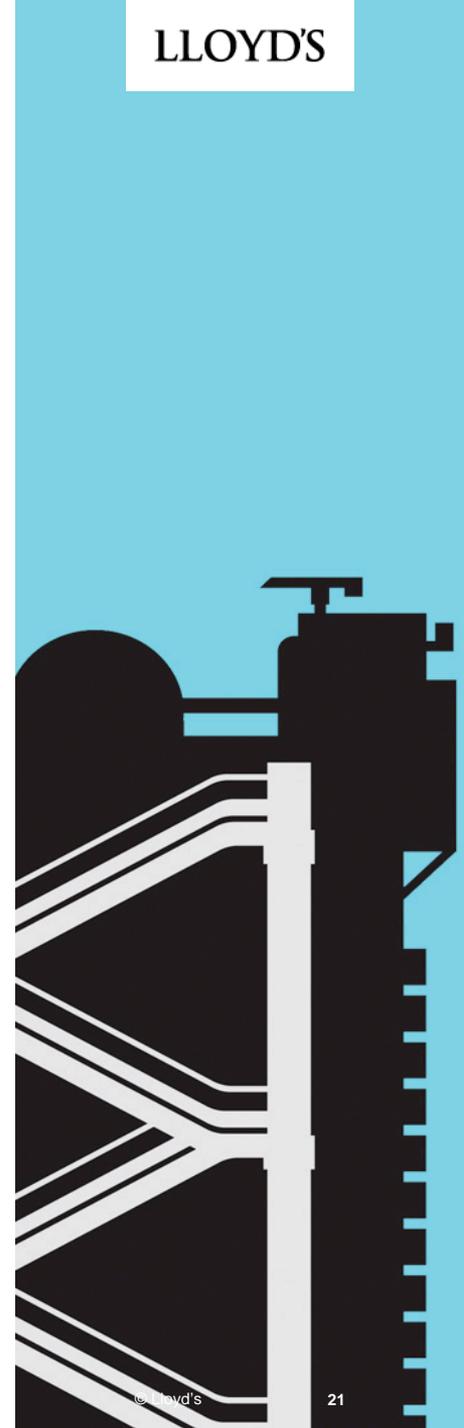
# CHANGES BY CLASSIFICATION



Pie chart legend:
- Underlying Risk Profile — 6%
- Model Methodology — 9%
- Model Parameterisation — 17%
- Data Updates — 38%
- Model design — 11%
- Governance/ Controls — 19%

- The most changes arose from Data Updates, 352 of all the changes reported

- Governance / Controls consisted of 170 of the total model changes

- 160 of the total model changes were in relation to Model Parameterisation

- Model Design resulted in 96 model changes

- 85 of the total model changes were due to Model Methodology

- Only 55 of all changes made to models were based on Underlying Risk Profile
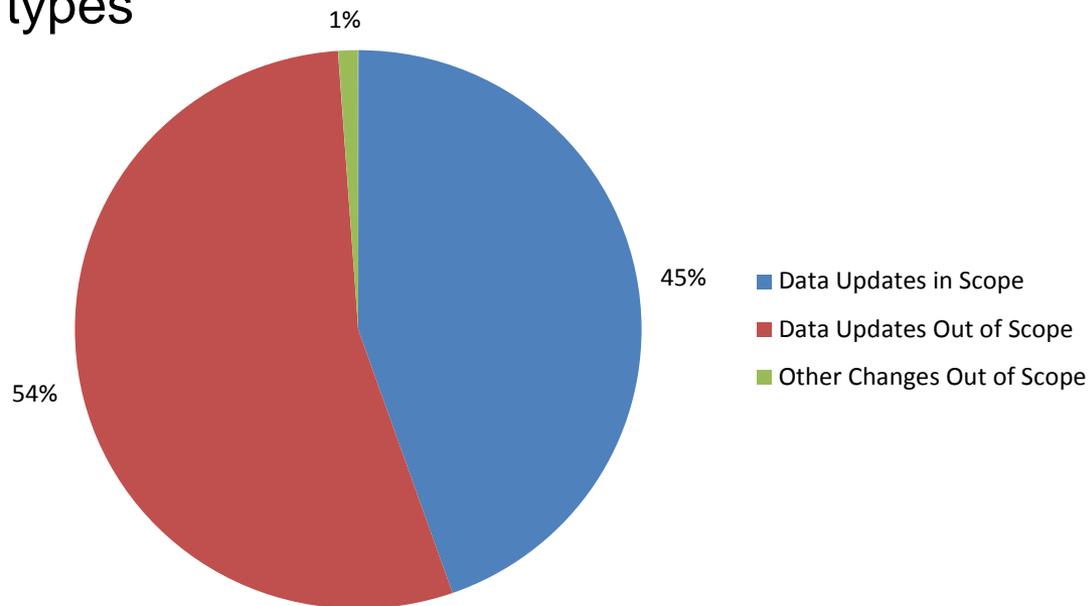
# QUALITATIVE VS QUANTITATIVE* MODEL CHANGES

► 173 of all the changes made were Qualitative Model Changes

► Quantitative Model Changes consisted of 745 of all the changes made

### Total

19%

81%

### Major

49%

51%

### Minor

17%

83%

■ Qualitative Major Changes
■ Quantitative Major Changes
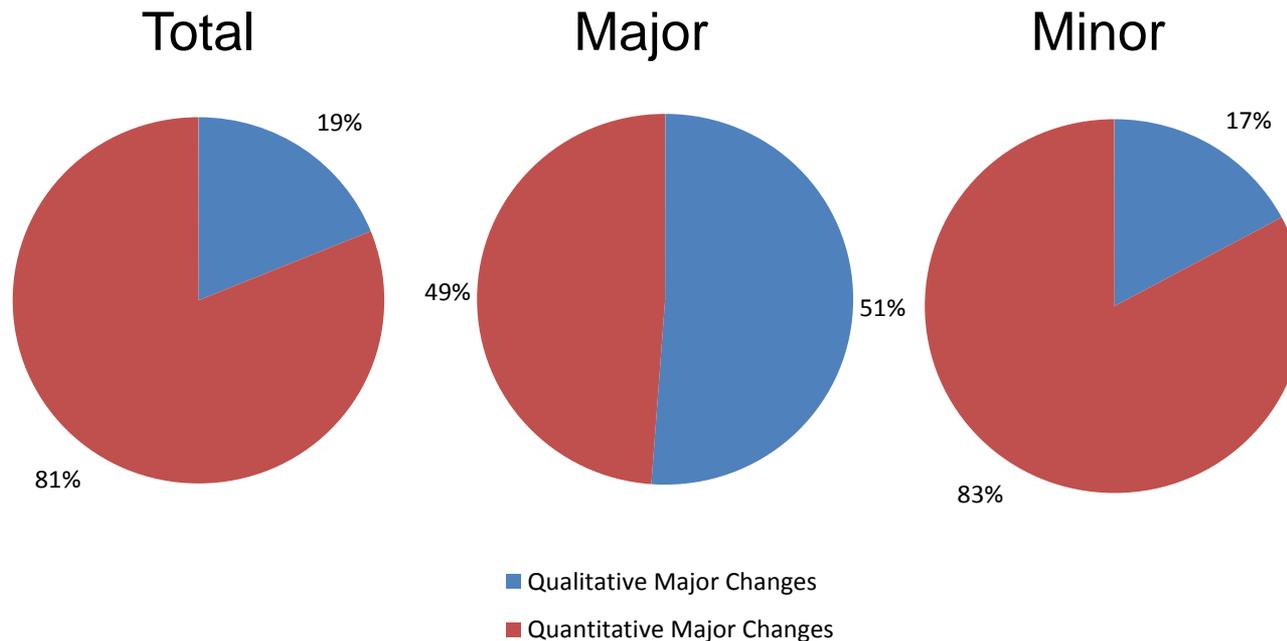
*As defined in managing agent model change policies

# DATA UPDATES AND OTHER CHANGES OUT OF SCOPE

► 352 changes as a result of Data Updates

► 191 changes reported were Out of Scope

► 157 of the Data Changes were In Scope of the Model Change Policy

► 4 of the changes Out of Scope from other change types



Legend:
- Data Updates in Scope (45%)
- Data Updates Out of Scope (54%)
- Other Changes Out of Scope (1%)

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# DISCUSSION ON MODEL CHANGE

10-15 minutes on your table to discuss the model change process:

► How Model Change Policies are working within each agent? Is there much amendment to the policy?

► Experience of the Lloyd's process?

► What specific issues have arisen in the Lloyd's process?

► How can we make it better for you?

► How many changes do you have planned for next year? Is this more/less than 2015?
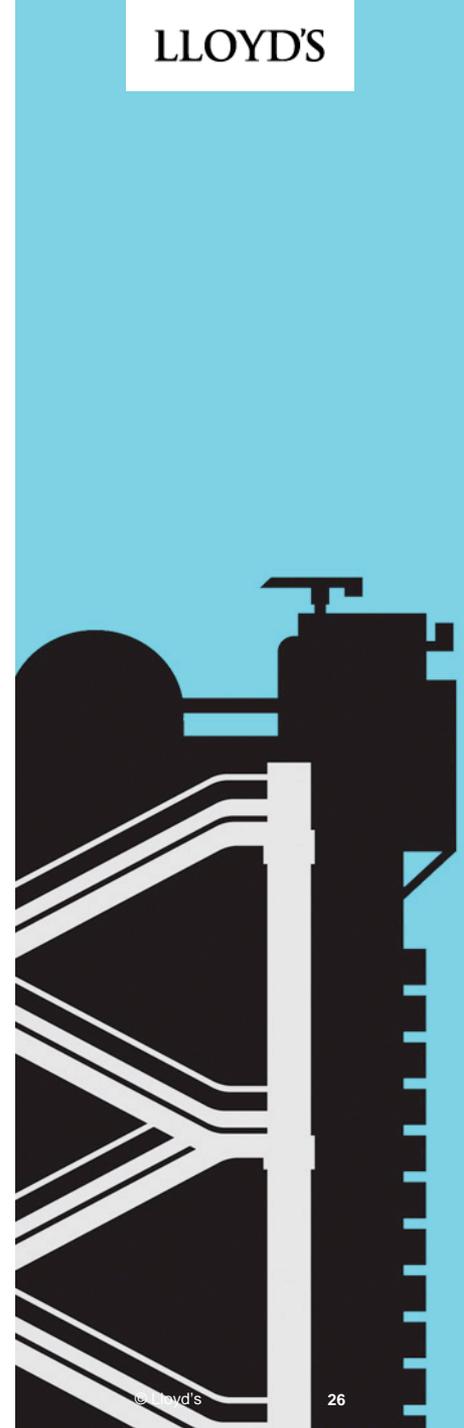
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# VALIDATION SELF-ASSESSMENT REVIEW

► Validation self-assessment submission received at end of March.

► Managing Agents have now all had feedback.

► Consistent feedback provided in relation to:

  – *VAL 1.1.6 – Managing agents shall ensure that the validation policy specifies at least an assessment by the managing agent of the quality of the validation process.*

  – *VAL 1.1.7 - Managing agents shall ensure that the validation policy specifies at least an assessment of the independence of the validation process.*

► Agents are not sufficiently articulating how they meet these requirements both in self-assessment and Validation Policy.

► Market wide effectiveness review to be undertaken in Q4 on this theme.

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# WHAT HAPPENS NEXT ?

► Slides will be made available on lloyds.com after both sessions

► Next scheduled workshop/briefings:

– Director Briefing (20 July)

– MS5 Change, Scope and Use launch briefing (11 August)