

# **SOLVENCY II MARKET BRIEFING**

# Agenda

- **Highlights and Lloyd's update**
- **FSA update**
- **Final Application reviews & next steps**
- **Wrap up**
- **Questions?**

# Highlights

- EU and FSA still committed to 2014 start date
- Lloyd's internal programme remains on track
- Lloyd's review of agent final application packs largely complete
- 2012 Market timetable issued and workshops in progress
- Change to Lloyd's application date and format

# EU sticking with 2014 start date...

- Time running out to finalise legislative framework
  - ECON vote 21 March
  - Trialogue April
  - Full Parliament vote expected July
  - Level 2 text unlikely before November
  - Transposition in member states may be later than 1 Jan 2013
- EU and FSA publicly committed to 2014 start date for insurers
  - Insurers must continue to plan for 2014...
  - ...but further delay not ruled out

**...but it's getting very tight!**

# Corporation still on track

- **Pillar 1** - Lloyd's Internal Model (LIM) development complete
  - model running successfully and producing MI which is feeding into Executive Risk Committee packs
  - focus now shifted to validation - David Lang, Head of Claims, appointed LIM Validator
- **Pillar 2** – Corporation ORSA now live and will go to March Franchise Board meeting
- **Pillar 3** – templates being developed and further clarification of requirements for agents will be published end of March
- **Executive Training** – extensive programme of 12 sessions for Franchise Board which began last September nearing completion.
  - LIM Sub-group established and coached to ensure in-depth knowledge of the model design and validation.

# New IMAP submission date means more efficient process for Lloyd's and FSA

- Submission date to the FSA changed to 27 July
- Lloyd's will have more time to assess and report status of agent progress including expected closure of material gaps at end March
- Allows more time for the completion of the new SAT and mapping from E-N
- Reviews will be more time efficient for both Lloyd's and the FSA
  - review process should be quicker if documents are more complete
  - fewer review and sign off meetings required

# Lloyd's hopes to agree with the FSA that we may use Solvency II models for 2013

- ICAS will still be in force for 2013
- Lloyd's wishes to use LIM and syndicate SCR calibrated models to meet ICAS to avoid having to maintain both ICA and SCR models
- SCR models **do not need** to fully meet Solvency II requirements
- SCR models **do need** to meet ICAS standards and deliver a robust number which provides an equivalent level of policyholder protection
- Lloyd's has responded to FSA technical queries
- Decision expected by end March

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# **Internal Models and the Syndicate Workstream – FSA Update**

**22<sup>nd</sup> & 23<sup>rd</sup> March 2012**

# Contents

## Our Approach

- Intended outcomes of the syndicate review
- The presentation approach
- Proportionality

## IMAP Overall

- Groups with Lloyd's operations
- The IMAP process

## Reflections from review & assessment work

# Syndicate workstream - Intended Outcomes

- To gain a view on how well syndicates are able to meet an equivalent standard to the Directive tests and standards
- To assess Lloyd's review processes over the syndicates
- To identify the impact on the Lloyd's Internal Model (LIM) and materiality
- Contribution to IMAP reviews for groups with Lloyd's operations



# The Presentation Approach (1/3)

- Directive contains c300 requirements (Level 1 and draft Level 2)
- For IMAP firms, ***all requirements must be met*** (art.112(5)) in order for full model approval to be given
- Lloyd's requires syndicates to demonstrate compliance with all directive tests & standards – Evidence Templates designed to achieve this
- In coming to our decision on the LIM, we need to consider how any deficiencies at syndicate level will affect Lloyd's ability to meet the tests & standards at LIM level
- The c300 requirements fall neatly into categories so rather than taking a bottom-up, checklist approach we are approaching our review work across a number broad review areas.



# The Presentation Approach (2/3)

- Review work initially structured around a series of presentations from firms, including:

<b>Use Test</b>	<b>Catastrophe Risk</b>	<b>Valuation</b>
<b>Diversification &amp; Aggregation</b>	<b>Underwriting Risk</b>	<b>Data</b>
<b>Risk Management</b>	<b>Reserving Risk</b>	<b>Documentation</b>
<b>Model Scope</b>	<b>Market, Credit &amp; Operational Risk</b>	<b>Outsourcing</b>
<b>Model Calibration</b>	<b>Validation</b>	

- A tailored, risk-based workplan has been put in place for each IMAP firm or each syndicate which takes into account:
  - Our existing knowledge of the firm
  - Model scope and approach
  - Market wide issues.



# The Presentation Approach (3/3)

- Presentation approach is focussed on compliance against key requirements and allows FSA to make informed judgements on areas which require more detailed review
- Evidential requirements will vary depending on our views of riskiness – this is not exclusively measured against contribution to SCR
- Internal *and* external validation is important in allowing proportionate judgements to be made
- IMAP firms to provide a detailed self-assessment against the directive tests and standards as part of their submissions which will play a key role in informing our judgements in a proportionate way.

# Proportionality – What It Is

- We take existing knowledge of individual firms into account when devising tailored, risk-based workplans and schedules of presentations
- Follow-up work will vary between firms depending on:
  - Existing knowledge of the firm and ongoing issues
  - Key issues uncovered during presentations
  - Scale, nature and complexity of the firm
- The consequence is that for certain requirements, we will consciously undertake less review work in coming to our views.
- Better validation by firms allows us to be more proportionate

# Proportionality – What It Is Not

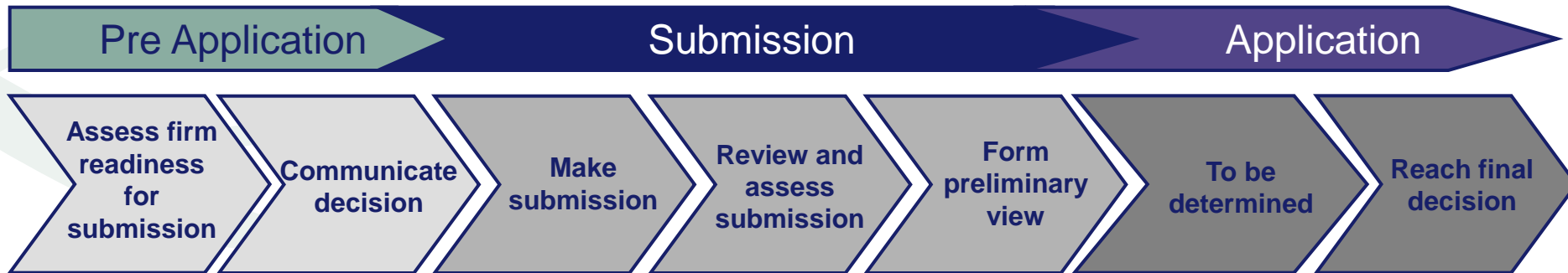
- Proportionality of review work does not mean being able to ignore ‘less important’ requirements in coming to our decisions – *burden of proof remains with the firms*
- Proportionality of review work does not mean being able to *ignore* areas that only make up a small portion of the firm’s SCR
- Proportionality of review work does not mean simply giving credit for a large capital surplus
- To date, firms’ validation work has not always been complete or of good quality, which has necessitated us doing more detailed work in certain areas than would otherwise be the case.



# Groups with Lloyd's Operations

- Syndicates with 'sister' insurance companies may be planning to use the same / a group internal model
- Presentations will therefore inform our work both on the syndicate and on the company
- In the majority of cases, follow-up work will address both entities at once
- Insurance groups will need to be in compliance with all applicable Directive tests and standards.

# The IMAP Process



- FSA must agree IMAP firms moving from pre-application to submission
- After receipt, there may be additional review work identified to cover material gaps
- To move out of pre-application we need to be satisfied that the submission is materially complete
- Complete documentation and validation is critical for efficient review
- For syndicate-only reviews, there is no distinction between pre-application and submission – all is captured within the LIM process

# Reflections from review & assessment work to date



## Level of firm engagement and progress

- Encouraging levels of engagement both within firms and with us
- Some good progress on implementation but some firms are falling behind

## Validation

- In general, validation work appears to be further behind than other workstreams
- This leads to difficulties both for firms (identifying critical issues) and for FSA (impacting on review work)
- Some firms do not appear to have scoped or reviewed external validation work sufficiently (e.g. validation is too narrow or restricted to P&L attribution)

# Reflections from review & assessment work (2)



## Catastrophe Risk

- In some cases non-modelled risks appear to be material
- Catastrophe modelling work appears to be 'siloed', with little interaction between the modelling team and the underwriting team
- Failure to meet outsourcing requirements

## Documentation

- Incomplete or otherwise undeveloped documentation. We expect better quality, and worry that weak documentation reflects poor underlying thinking about the issue and lack of senior engagement
- Some documentation appears to be produced solely for our benefit – documents should help to show good use and embeddedness of the model.
- Evidence of ownership at an appropriate level within the business needs to be demonstrated – too much being parked in the actuarial function

# Reflections from review & assessment work (3)

## Model Change

- Little thought being given to why a robust model change policy is required:
  - framework within which the firm will develop and control the model
  - key basis on which regulator will have opportunity to consider and approve changes to the model
- More thought needs to be given to categorisation of changes into 'major' and 'minor'. The approach needs to take qualitative as well as quantitative factors into account
- Model change policies being developed in isolation from use and validation policies or being developed purposively

# Conclusions

- FSA must gain a view on how well syndicates are able to meet an equivalent standard – not an optional piece of work
- Presentation-led approach allows us to focus our review work in an efficient and effective manner
- Existing knowledge is used in planning work, assisting in the application of proportionality and targeting our work
- Good validation and documentation helps us to delivery better reviews
- After the Lloyd's submission, further targeted work may be required to address any material gaps prior to Day One
- Note on S2 and ICAS – 2013 capital setting

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# A reminder on the aims of the FAP submission and review process

## **For agents to:**

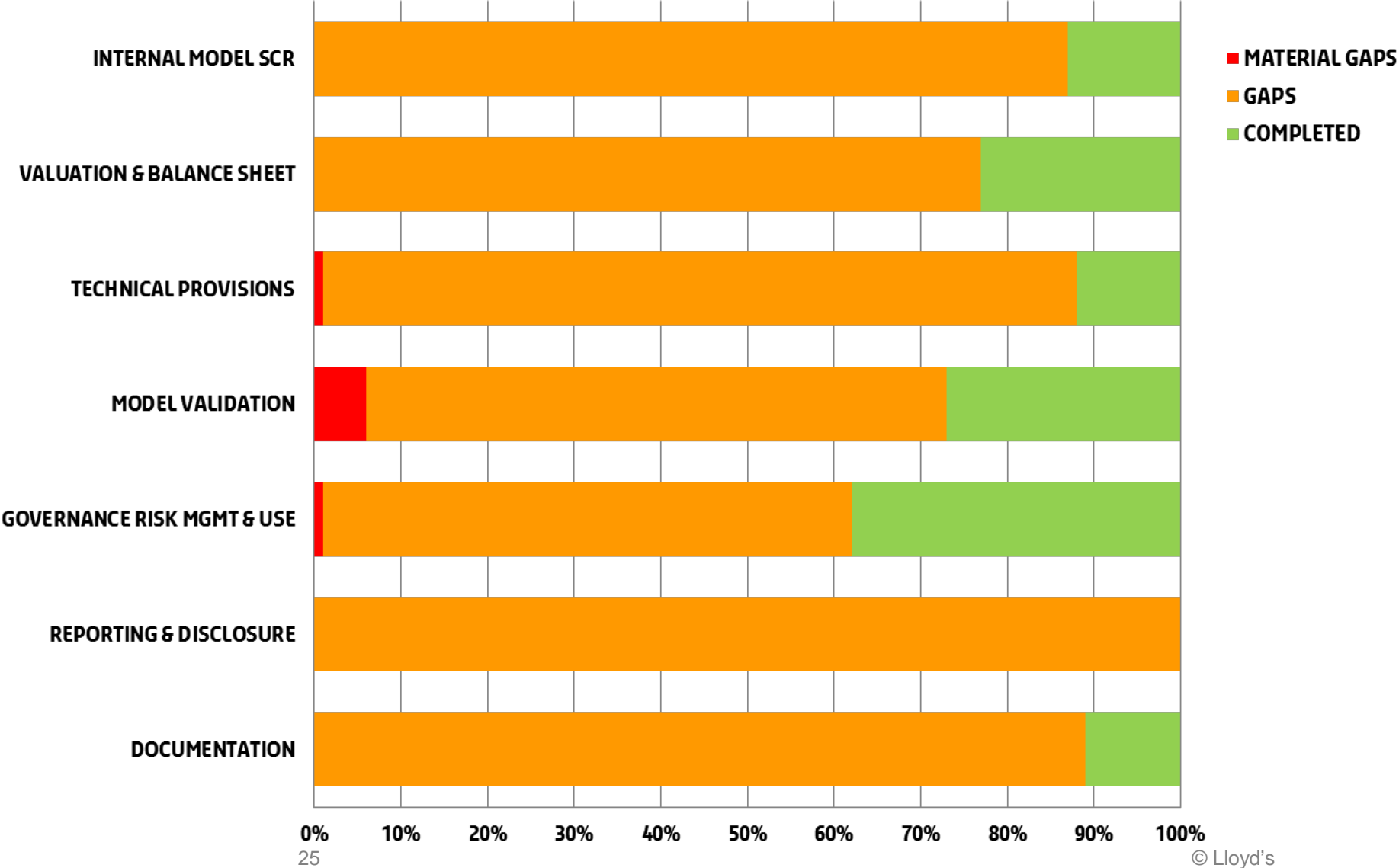
- present the current status against Solvency II test and standards
- capture all evidence available to support this
- set out the work needed and timelines to address any gaps

## **For Lloyd's to:**

- provide clarity to all stakeholders on the market's Solvency II readiness
- arrive at a “conditional” recommendation on model authorisation for each agent
- drive 2012 work thematically and with individual agents based on gaps



# Level of gaps reported by agents in self assessed scores for all workstreams



# High level findings on FAP submissions

- ✓ FAP of good quality with all supporting documents completed
- ✓ Clear analysis of gaps with detailed dates for completion and resources allocated to tasks
- ✓ Significant progress made by agents in Q4
- ✓ Only 2% material gaps across market on reported scores
- ✗ Explanation on gaps does not clearly set out further work required to close
- ✗ Additional gaps uncovered by Lloyd's review
- ✗ Underlying documents do not always support scores and do justice to processes in place
- ✗ Previous feedback not always clearly addressed

# Some common issues and gaps arising from detailed reviews

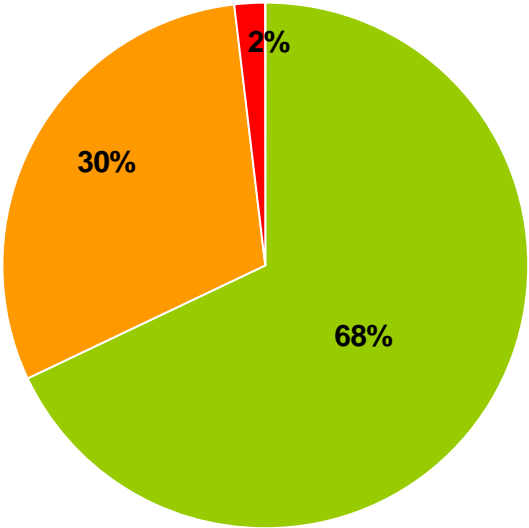
- Profit & Loss attribution – cycle not yet completed for many agents
- Validation - independence needs to be clearly explained
- Model scope – Catastrophe and ESG models out of scope
- Model Change – quantitative trigger and aggregation of minor changes
- ORSA – forward looking assessment
  
- Lloyd's reviews based on a sample of core documents
- Feedback is based on Lloyd's judgement and interpretation of requirements
  - aim to strike the right balance but not necessarily always right
  - challenge if you don't agree with us and provide rationale

# FAP reviews are ongoing through Q1

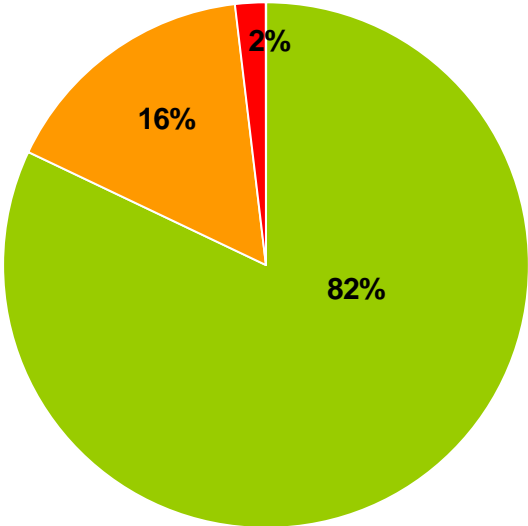
- Dry Run Oversight Panel (DROP) meetings to consider each agent's FAP
  - began 20 February and will complete by end March
- Each agent pack presented to DROP includes 20 individual review documents
  - consistent set of documents reviewed and produced for each agent
  - involves 30 plus individual reviewers across all workstreams
  - all review documents will be provided to agents for feedback purposes
- Results communicated to agents as soon as possible after DROP session
  - formal letters will follow

# 52 FAP reviews completed to 21 March and revised agent ratings issued

By agent



By Materiality  
(2012 ICA)



Rating	Summary
Green	Will meet provided that
Amber	Will not meet unless
Red	Will not meet unless with material concerns/FAP rejected

**Note** - 14% of agents by materiality yet to be reviewed

# What are the key drivers of DROP decision?

## Agent will meet: (GREEN)

- ✓ We have confidence based on evidence presented that agent will close gaps by 30 June 2012
- ✓ Evidence reviewed is clearly addressing tests & standards even if further work is required
- ✓ Gaps identified by the agent are largely in line with review findings
- ✓ Agent can demonstrate clear plan in place with detailed dates for completion and resources allocated to tasks

## Agent will not meet: (AMBER/RED)

- ✗ We do not have sufficient evidence at this time to state with comfort that agent will close gaps by 30 June 2012
- ✗ Reviews show that underlying evidence is not meeting the tests and standards in multiple areas
- ✗ Review findings show that there is significant additional work to be completed over that planned by agent
- ✗ No clear plan in place with detailed actions, timelines and/or sufficient resources allocated to complete tasks

# Implications of decision and rating applied

<p><b>RED</b> (CRITICAL ISSUES)</p>	<ul style="list-style-type: none"><li>• FAP has been rejected by DROP</li><li>• Agent is unable to demonstrate that they will be able to meet the tests and standards</li><li>• At risk of imminent prudential measures</li></ul>
<p><b>AMBER</b> (MATERIAL ISSUES)</p>	<ul style="list-style-type: none"><li>• DROP view is that agent is at risk of not meeting tests and standards unless significant remedial action is taken</li><li>• At risk of prudential measures from end of Q2 if remedial action not taken and evidenced</li></ul>
<p><b>GREEN</b> (ON TRACK)</p>	<ul style="list-style-type: none"><li>• DROP view is that agent will meet tests and standards <b><u>provided</u></b> gap plan is adhered to and progress can be evidenced</li><li>• Not at risk of prudential measures being applied</li></ul>

# Ratings will be kept under review and actions followed up

- **Remember - this is a point in time assessment and could change either way**
- Ensure that you evidence progress and be open on any changes or slippages
- Demonstrate that you have addressed feedback given by Lloyd's
- Agent Status Reports will help track progress on gaps
  - needed monthly as a minimum
- Lloyd's will follow up on feedback arising from reviews
  - re-submissions of some documents may be required



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# We're coming to the last 3 months of a 3 year process ...

- Change to LIM application date has no impact on published timetable
- Material gaps **must** be addressed by 31 March 2012
  - important so Lloyd's may reflect this in LIM submission
  - closure of remaining gaps by 30 June 2012 key for end July submission
- Lloyd's is providing feedback from FAP reviews as quickly as possible
  - working with agents to agree gap status and actions
  - follow up work will be risk based and look to evidence completion status

... so please stick with it!

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