

Catastrophe Risk Operational Framework (CROF)

From Minimum Standards to Best Practice for Natural Catastrophe Risk

Date 24 May 2019

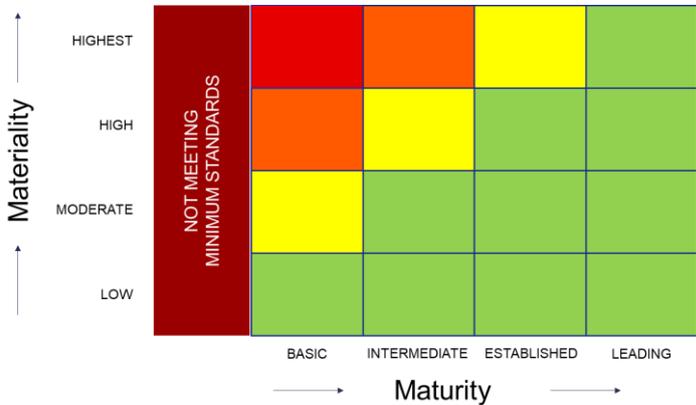
Lloyd's is a specialist market for catastrophe risk with a centralised Catastrophe Risk Appetite. Lloyd's manages this on the basis of Syndicate ratios; however, this is a crude mechanism, and can be improved by acknowledging differences in capabilities of Managing Agents.

Lloyd's has developed a framework to establish the operational Maturity and risk Materiality of natural catastrophe risk management within Syndicates. This Catastrophe Risk Operational Framework (CROF) supplements Minimum Standards and will allow Lloyd's to promote responsible growth by recognising the best.

The CROF has been designed to support the optimisation of natural catastrophe risk exposure. While low materiality syndicates may only demonstrate basic capabilities, the most material syndicates are expected to employ leading capabilities. Those demonstrating best practice should have opportunities to write more catastrophe exposure, and Lloyd's will have greater confidence in the market's management and representation of catastrophe risk.

Figure 1 illustrates how Syndicates will be assessed, on the combination of Maturity (operations) and Materiality (risk). All Syndicates are expected to sit within the green areas of the grid. Where a Syndicate is within the lower left green portion of this grid, improvements in their operational Maturity will provide them with the opportunity to take on greater risk and move upwards towards the top right.

Figure 1 – The Maturity / Materiality axes



The Maturity of a Syndicate's natural catastrophe operations will be assessed across 4 areas: Culture, Technical, Application and Infrastructure. These categories were developed

in conjunction with the LMA Exposure Management Working Group which has validated their appropriateness. Materiality will be assessed using data already collected by Lloyd's as part of business planning and regular supervisory processes. This includes, but is not limited to, LCM, RDS and Supplementary Information. *Please see further guidance for definitions of the 4 areas.*

This is a principles-based framework, with principles defined for the categorisation from 'Basic', to 'Intermediate', 'Established', and 'Leading', and across all components.

CROF will inform 2020 business planning; however, given that this is its first implementation, the primary messaging around Cat Risk Appetite will remain consistent with 2019: the Cat Risk Appetite metric, measured by LCM5 region/perils (combined) at a 1-in-200 AEP FNL relative to ECA-plus-expected-uProfit, must not deteriorate between plans. Lloyd's will communicate results of assessment to Syndicates within the 2020 business planning process.

Lloyd's will not communicate detailed scores, but all Syndicates will be given an indication of which area of the grid in figure 1 they are located and will be provided with an opportunity to discuss the assessment.

Who does this change apply to?

While it covers the activities of the Exposure Management (EM) team, it is not specific to the EM team. It also captures the broader use and applications of EM from senior management and other business functions.

The framework is inclusive of direct, delegated and reinsurance business, and all processes, regardless of whether they are internal, external, or undertaken by another group entity.

What do I need to do next?

Lloyd's is assessing Maturity and Materiality ahead of the 2020 business planning process. Syndicates are not expected to create additional documentation for this process. Lloyd's will evaluate operational Maturity using information already held, following up with relevant teams where necessary to clarify specific points. This may be supported by interviews, and your teams will only be asked to provide additional documentation in areas where Lloyd's requires more detail on your approach.

Further guidance

The **View of Risk** refers to the Syndicate's representation of natural catastrophe risk, including all models (internal, vendor models etc), adjustments, and assumptions to get to the modelled risk profile. A **model** may refer to a single model that informs the view of risk or supports an application of exposure management.

Where non-EM teams are discussed, other business functions are defined as underwriting, claims and reserving, and capital, and any other area that makes active use of EM in informing commercial analysis and decisions.

The maturity matrix covers components grouped across four sections:

Culture: Culture; including governance, use, and embeddedness of exposure management throughout the organisation.

Technical: The technical view of risk, and whether this is well-considered and well-derived

Application: The execution of different applications of exposure management, with the EM team and to – or by - other business functions (e.g. Risk Selection, Risk Transfer, Capital modelling). Includes the strength of interaction between the EM team and other functional teams, and the consistency of application by other functions.

Infrastructure: The infrastructure of data, technology, and human resource, which underpins the technical view of risk and the exposure management applications.