Capital and Validation Briefing

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July 2023

Agenda

Agenda Item	
1.	February Capital Briefing - Recap
2.	Key areas of focus for the 2024 YoA LCR Submission
	a) Key Capital Themes
	b) Focus Areas
3.	Fast Track Process
4.	Reserving Tests
5.	Lloyd’s Standard Model
6.	Responses to Market CPG Feedback
7.	Practical Considerations
8.	Wrap Up
	Appendix – Key Findings from Cyber Thematic Review

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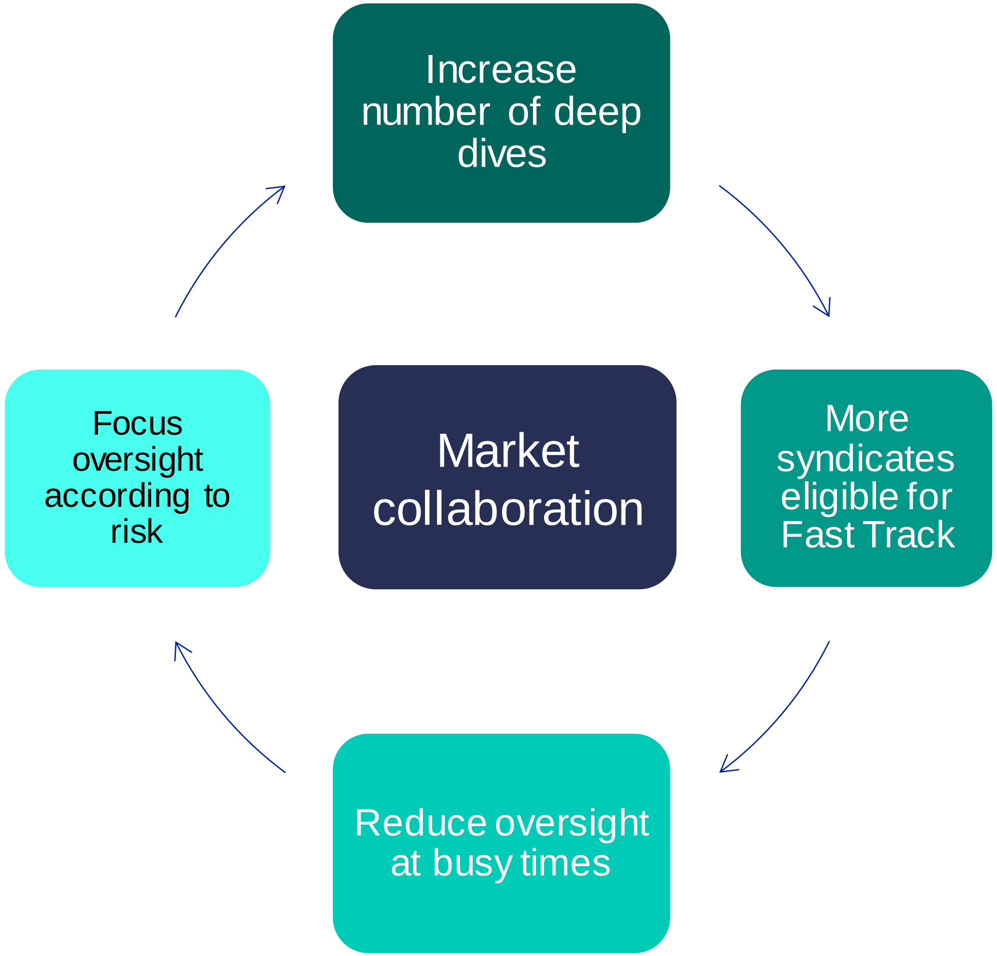
February Capital Briefing - Recap

We have responded to feedback provided by the market last year.

- **Reduced thematic work** to acknowledge that syndicates may need time to **revisit BAU processes** after a few years of focus on "hot topics".
- Good progress made in **shift oversight away from the busy times**.
- Continued embedding risk-based oversight – using the Principles of Doing Business at Lloyd's as a framework.
- The Principles rating are used to inform all of our oversight activities, e.g.
  - Assessing syndicates for **Fast Track** during CPG reviews.
  - Included in the process for **reviewing Major Model Changes**.



Key areas of focus for the 2024 YoA LCR Submission

Key capital themes

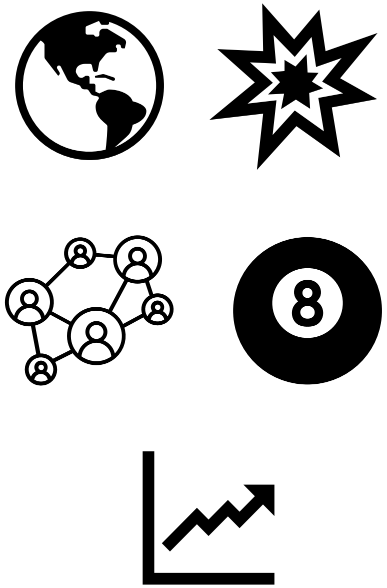
Setting the scene

The past is not always representative of the future

The risk landscape continues to change, which should remind us that past events are not always a realistic barometer for the future.

The “polycrisis” of a pandemic, unexpected geopolitical conflict, step-change in interest rates to tackle inflation and fragility in the resilience of some international banks has created conditions that impact insurers across all operational dimensions.

Syndicates should be stepping back and thinking about their modelling approach holistically, do the mechanics of your models and risk frameworks allow you to respond appropriately to prevailing conditions?

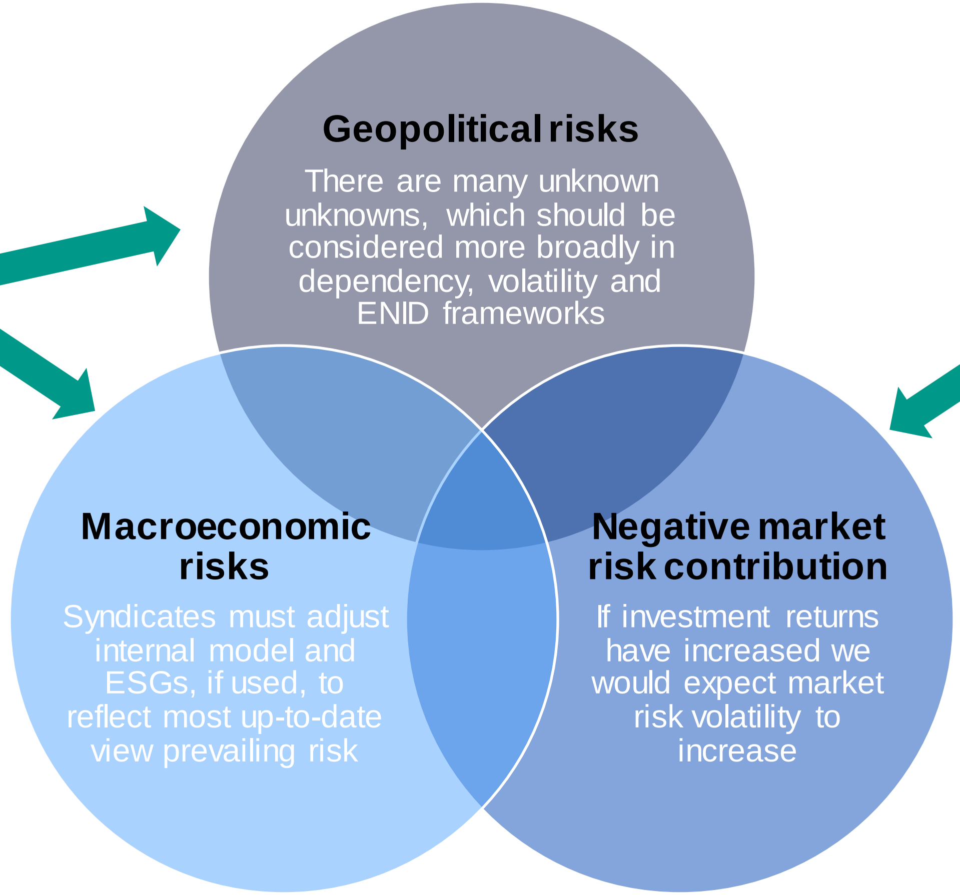


Focus areas

Thematic areas for the market to consider when setting capital

Syndicates need to demonstrate areas of heightened uncertainty have been catered for in the model:

- Dependency – tail dependence may need to be added between classes and risks which have not previously been parameterised for it; allowance may be required for aggregation of events (e.g. economic, man-made, natural disasters); linking market risk only to financially exposed classes may not be appropriate
- Volatility – classes may be affected directly or indirectly, and the model must allow for both; likelihood of certain events may be higher now than before; there is uncertainty in how inflation and interest rates will continue to develop and how central banks will respond in different geographies
- ESGs – limitations should be understood and mitigated, for example scenarios should capture the recent past and internal views of risk



Negative market risk review

Negative contributions from market risk will only be accepted where they are well justified and validated.

Syndicate review/validation should consider:

- Drivers of downside insurance risk around the SCR and how market risk should behave in these scenarios;
- Scenarios for downside market risk (such as systemic risks arising from inflation and geopolitical conflict) and how these should impact insurance risk and other risk categories; and
- How well market risk contribution captures above drivers simultaneously impacting market risk and insurance risk at the SCR setting level.

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Focus areas

Data collection

- Data collection will be focussed on geopolitical risk, macroeconomic risk and market risk contribution

- Market risk oversight was deprioritised last year in light of other activities. Our focus area review is to ensure that syndicates understand and have validated:
  - The drivers of market risk that influence capital compared to what is expected; and
  - Treatment of more uncertain financial market conditions now, compared to the recent past

  Only syndicates with negative market risk contribution are required to complete the market risk focus areas; the 'negative market risk template' will not be in use

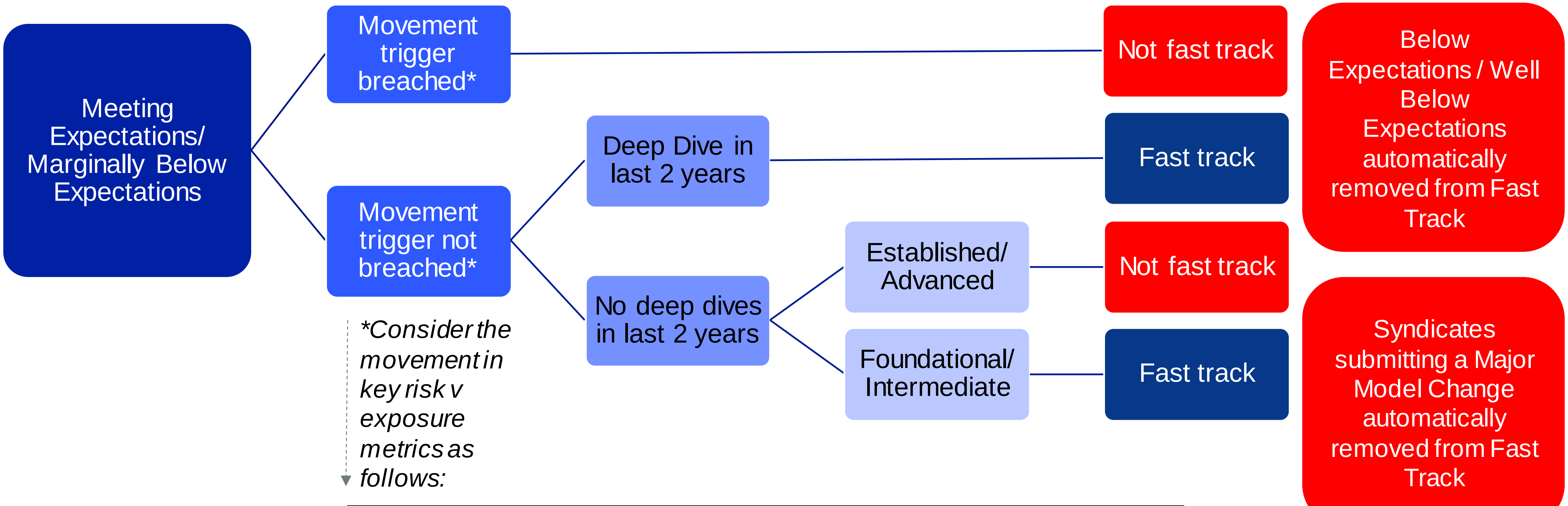
- Geopolitical and macroeconomic data collection will be focussed on scenario analysis and how syndicates have validated that their models reflect prevailing conditions

- The scale of data collection is reduced from last year and our review process continues to be risk-based, so not every syndicate will be required to complete the entire data request or be reviewed by Lloyd's

The Fast Track Process

Fully Implementing the Principles-Based Approach

Last year's Fast Track Process

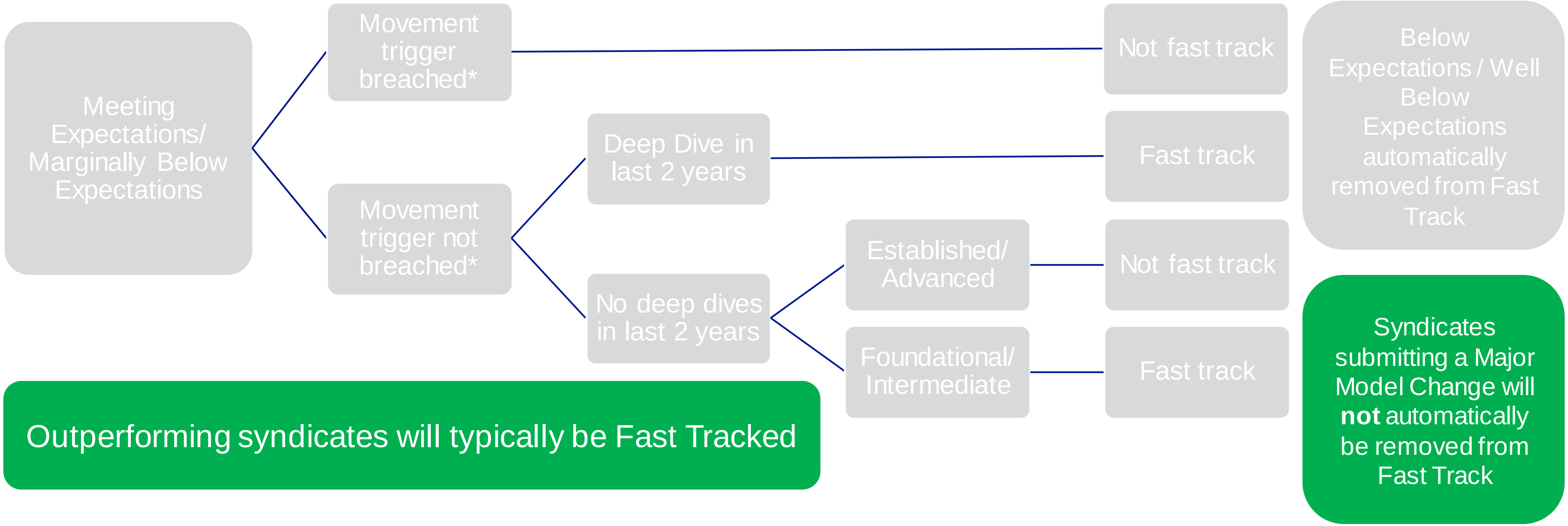


**Consider the movement in key risk v exposure metrics as follows:*

% change SCR(U) stress to exposure	% change Premium Risk (U) stress to exposure	% change Reserve Risk (U) stress to exposure	% change SCR(1) stress to SCR(U) stress
-10%	-20%	-20%	-20%

Fully Implementing the Principles-Based Approach

Updates to the Fast Track Process



We continue to reserve the right to apply judgement and use qualitative overrides!

What can you expect from Fast Track?

- Fast Track reviews focus mainly on high-level movements in risk type and risk vs exposure metrics. In general, requests for further information from the syndicate will be very limited.
- For Fast Track syndicates, loadings are only applied for failed minimum tests.
- The more detailed reviews focus on understanding the full scale of movements in capital, as well as risk-to-exposure metrics across all risk types and classes.
- Fast Track does not change the requirements of the capital submission, but it does increase our comfort level to reduce and defer queries to outside of the CPG window.
- We can't confirm Fast Track status until capital submissions have been received as the requirements of Fast Track relates to the movement in capital and other key metrics
- If we find material issues during a review of a syndicate on fast track, we will remove the syndicate from Fast Track and increase the review level.

Reserving Tests

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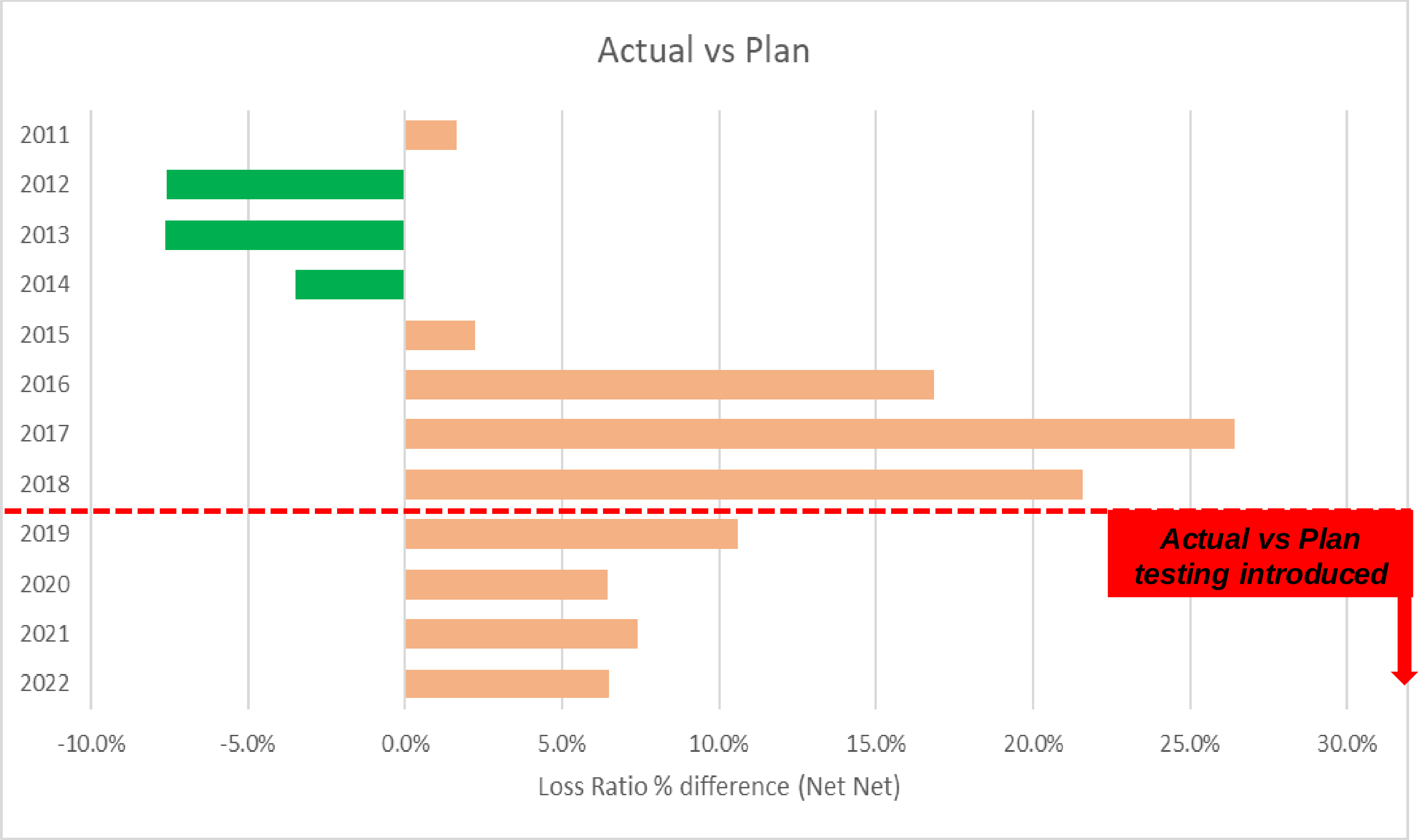
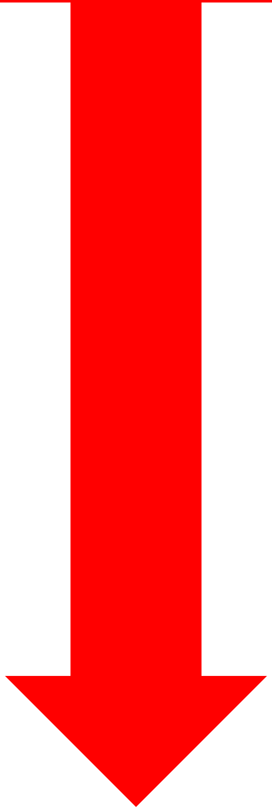
Positive trend in gap to plan and capital loadings

Since the Actual vs Plan testing was introduced the quantum and number of Lloyd's loadings has significantly reduced year on year to nil loadings in the two most recent capital setting exercises.



Actual vs Plan Test Outcomes



2020 Capital Setting
£150m loading
8 syndicates

2021 Capital Setting
£184m loading
6 syndicates

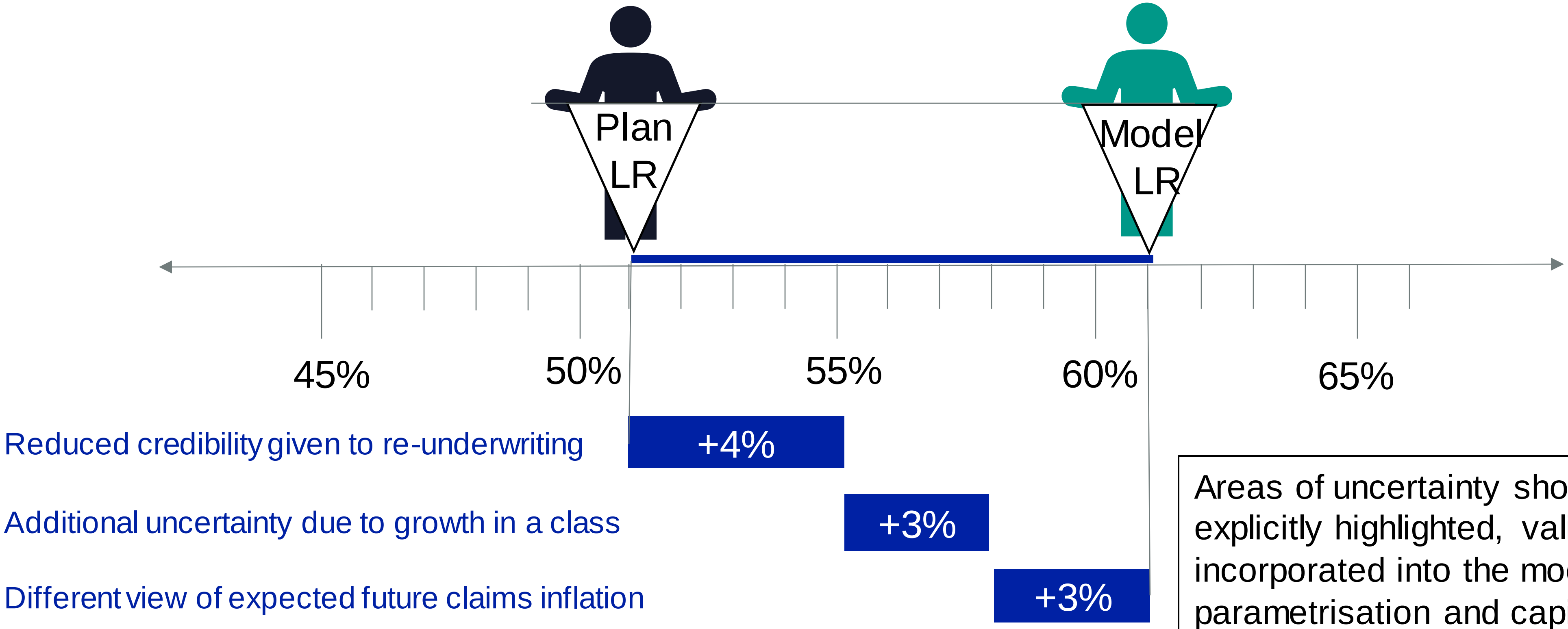
2022 Capital Setting
£0m loading
0 syndicates

2023 Capital Setting
£0m loading
0 syndicates

Continued focus on model loss ratio appropriateness

With the improved trend on model loss ratio performance **we have removed the Actual vs Plan testing** framework

We highlight that **model loss ratio appropriateness is still a key area of focus for Lloyd's**



Areas of uncertainty should be explicitly highlighted, validated and incorporated into the model loss ratio parametrisation and capital calculation

How will Lloyd's assess model loss ratio appropriateness for the 2024 LCR submissions?

During the 2024 Year End capital setting process we will be **assessing two key checks as stated in the LCR guidance:**

1. Minimum "floor" model loss ratio check, and
2. Review of material decreases to model loss ratio uplift versus the 2023 LCR submission

We will apply capital loadings where we have concerns on the above from our assessment.

We will continue to retrospectively adjust capital as part of the mid year 2024 capital setting for syndicates with systemic evidence of not performing to capitalised loss ratios.

Further details on these can be found in the 2024 LCR instructions

No other material changes to the reserving tests – details on the 2024 Reserving Tests can be found on the Lloyd's website: "Reserving Tests of Uncertainty – 2024 process.pdf"

Lloyd’s Standard Model

Lloyd's Standard Model

Embedding into BAU

- **2023 capital setting was the first time that the LSM was used**
  - It will continue to be developed and refined
  - Many good suggestions raised by the market already for future development and investigation
- **LSM expected to have minimal changes for 2024 capital setting**
  - However, Working Group discussion can cover any high materiality issues
  - Scope of application – i.e. new syndicates, typically uSCR <£100m, to remain unchanged
    - Open to engagement from syndicates looking to explore using the LSM

Changes made since initial 2023 release

1H 2023

LSM updated for March CIL assessment

Planned timetable ahead of 2024

End June

Working Group
- Discuss Lloyd's proposed updates
- Opportunity for market suggestions for LSM changes

End July

Release updated LSM template for 2024 capital
- Incorporating changes following Working Group
- May include parameter updates

Mid- August

Updated Lloyd's Guidance / Instructions on LSM
- To follow release of LSM template

Responses to Market CPG Feedback

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Working with the market to achieve better outcomes

Focus on the most material areas of risk during the time critical CPG period

Market Concern	What we said we'd do	What we've done
Delays in sending out feedback/reviewing some elements of the submission	• Ensure that additional time for feedback write up is factored into the CPG planning process	• More risk-based review so we can respond to syndicates in shorter timeframes. • Restricted the scope of Focus Area/thematic reviews • Removed the AvP test • Additional time has been factored into planning to write feedback as we go this year.
Insufficient time to respond to indicative loadings	• Increase number of syndicates on fast track via additional deep dives. • Consult with CALM for alternatives to the current loading process.	• Discussed in the LCR working group • Give capital team heads up on indicative loadings • Advanced notice of response timeframes • Advanced notice (via LCR instructions) of information required when plan is resubmitted • Continue to waive immaterial loads.

Working with the market to achieve better outcomes

Focus on the most material areas of risk during the time critical CPG period

Market Concern	What we said we'd do	What we've done
Capital Fast Track not beneficial	• Intention is to not have thematic Focus Area reviews during CPG this year that reduce differential benefits of Fast Track. • Reduce workload during CPG – not the work required pre-submission.	• We have more clearly defined what the fast track is and is not intending to deliver. • We have restricted the scope of thematic reviews conducted during CPG, with the remainder to occur after CPG.
Slow communication from POCs during busy periods	• Reminder of escalation channels • POC best practice training sessions within MRC	• We have re-run Point of Contact best practice sessions. • We have set up drop in sessions for the market. • We have reminded syndicates of the Chief Actuary/ Head of Actuarial Oversight/Syndicate Capital Senior Manager as escalation points. • Head of Actuarial Oversight and Syndicate Capital Senior Manager will schedule time for escalations. • We are considering a new regular communication plan to CFOs on the state of capital submissions across the market throughout the CPG window.

Practical considerations

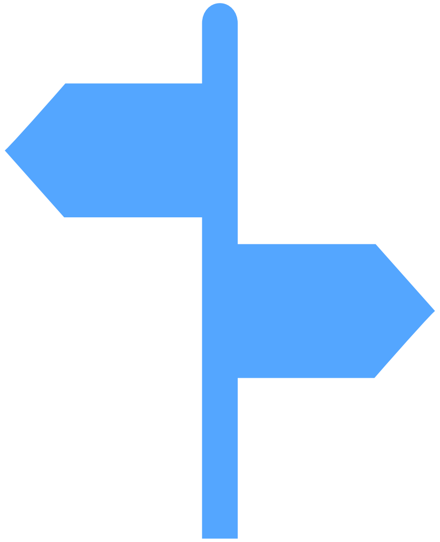
Compressed 2024 YOA timetable in response to feedback

Syndicate group	SBF submission date	LCR submission date	Validation report submission date
Phase 1	4 Sept	7 Sept	14 Sept
Phase 2	11 Sept	14 Sept	14 Sept
Phase 3	25 Sept	28 Sept	28 Sept
Phase 4	2 Oct	5 Oct	12 Oct

- Timetables for Phase 2 and 3 syndicates are compressed this year, to address market feedback around reducing time between plan/capital submission and approval.
  - Given the compressed timelines, for these phases we're unable to accommodate the validation report being submitted 1 week after the LCR.
- We continue to support year-round validation, rather than requiring validation to all be done on the final version of the LCR.

Tips for a great submission

- **We tend to give the same feedback repeatedly!**
- **The analysis of change is the key document we use to review submissions**
  - Don’t just comment on movements – justify them!
  - Remember to comment on movements in diversified capital.
  - Direct our attention to the important factors causing movements in capital
- Make sure you **address prior feedback and loadings**…
  - …by the deadline stipulated.
- Take care when completing the **focus areas return**
  - This is a key part of the submission – make sure it isn’t an after-thought.



Signposting, Signposting, Signposting

Wrap-up

Wrap-up

- **We learnt a lot from prior year CPG feedback**
  - Have taken a number of actions to return to a position where process is smoother and benefits felt
  - We welcome feedback year-round on how we can work better together

- **Reviews more risk based with:**
  - Improved fast track process
  - Less thematic review
  - Continued oversight through the year to reduce burden during CPG season
  - Removal of AvP test

- **Current landscape is complex and fast-moving**
  - There is a need to continuously ensure the model is appropriate and that will be harder as a result
  - Areas of focus this year will be negative market risk contributions, and geopolitical risk and macroeconomic risks

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What does the rest 2023 look like

(Leading into LCR submissions)

Q1

- Publication of all Capital Guidance – including Legacy Reinsurance Guidance
- Partial IMAP reviews
- Deep Dives commenced
- Capital briefing (20 February)
- Retrospective loadings assessment (Lloyd's to inform syndicates which will be loaded by 2 March)
- March reassessment templates, LSM, and where necessary, MY CIL LCR resubmissions (2 March)
- IMO returns (6 March)
- Principles Attestation to Lloyd's (31 March)

Q2

- IMAP reviews
- Deep dives reviews
- Capital and Validation briefing (June)
- Capital Market messages (June)
- Exposure management model completeness return (published in June)
- Updates on Reserving Test on Uncertainty
- Syndicate Categorisation confirmed ahead of CPG (June)
- BAU: Major Model Change reviews

Q3/Q4

- LCR instructions and Focus Areas return published (early July)
- Exposure management publication of non-natural catastrophe best practice guide
- NED Forum
- LCR submissions
- Standard formula return

Appendix

Key Findings from Cyber Thematic Review

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Considerations for modelling cyber risks

Playback from our Cyber Thematic review

- **Examples of good practices when modelling cyber risk are:**
  - assessing the credibility of external vendor models;
  - considering a broad range experts when making and reviewing material expert judgements;
  - explicitly registering and acting on the limitations of relying on expert judgements;
  - clearly communicating the level of uncertainty in parameterisation as well as the areas of outstanding work that need to be addressed and
  - demonstrating a good understanding of the root causes for cyber event losses and how these might change through time.
- **Areas to consider when modelling cyber risk should include:**
  - the need to model non-affirmative cyber;
  - outwards reinsurance not responding as expected due to untested policy wordings;
  - how cyber can drive dependencies between risk categories and
  - that Lloyd's requires a minimum level of correlation between cyber and all other losses.

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