Capital Briefing

2021

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Agenda

- Opening Remarks
- Process Changes in 2020
- 2021 SCR reviews
- COVID-19 Reviews
- Priorities for 2021

Opening Remarks

Burkhard Keese

Chief Financial Officer

Our target is to minimise review required in planning season

Our focus will be on process improvements

Moving to a principles-based approach

Fast track pilot to be boosted

Model changes to be prioritised

Only actual performance drives your capital

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Moving to a principles-based approach

- We will rely much more on your Pillar 2 controls
- We will assess your model holistically

Fast track pilot to be boosted

- Aim to maximise participation in 2021
- Key part of decoupling capital review and planning season

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Model changes to be prioritised

Today:

- 100+ model changes in 2020
- Timing was sometimes less then optimal

Tomorrow:

- Every syndicate to give extended notice on all non-essential model change
- We will prioritise review and approvals before you begin work

Only actual performance drives your Capital

You must get your starting point right!

Open question:

- Would it be easier if we all agree that your underwriting performance is your average 3 year calendar year performance?
- Any plan deviation is assessed by calendar year plan against actual calendar year?

Let's discuss…

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Process Changes in 2020

Cameron Beveridge

Senior Actuary

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A reminder of the priorities at start of 2020

(Pre-COVID)

Model changes – new guidance in force

Improved submissions – review of guidance

Fast-track approach – Changes to review process

Revamp of the LCR forms - preparation

… and how they changed in light of COVID-19

- COVID-19 – clear expectations for models and consistent review framework
- Model changes – new guidance in force
- Improved submissions – review of guidance
- Fast-track approach – Changes to Review Process

No revamp of LCR forms until IMO returns reviewed

Reasons

– MDC priorities – clear that migrating other returns higher priority than re-vamping the LCR return

– PRA wider review of reporting requirements – no point collecting the IMO return as part of LCR forms if it then changes

– Request to pursue reduced reporting requirements with PRA before including IMO data in LCR forms

Outcomes of Working Group

1. For majority of syndicates submitting IMO return with LCR will be difficult (as already resource strain and a lot of extra information to review)
2. Earliest syndicates could submit the IMO return is in November

PRA have removed requirement for syndicates to report discounted information in IMO return

In the future IMO return might have to be submitted earlier

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All MCPs reviewed – new model change guidance now fully in force

More or less all agents submitted major model changes on their MCPs – mainly reviewed over Q2 2020. 1/4 rejected and had to resubmit. Main reason – distinction between data vs risk profile changes.

Main objectives of new model change guidance were:

1. Expectations on model changes clearer – better service/faster turnaround

- Further clarification in guidance this year, in particular on external model changes
- Of 36 major model change applications (not in September) 61% were reviewed within 8 weeks, and 96% with 9 weeks
- Highlighting the difference between validation and justification, and making the expectations from each clearer
- At times still issues with specific validation for each MMC

New Model Change Guidance now fully in force

Main objectives of new model change guidance were:

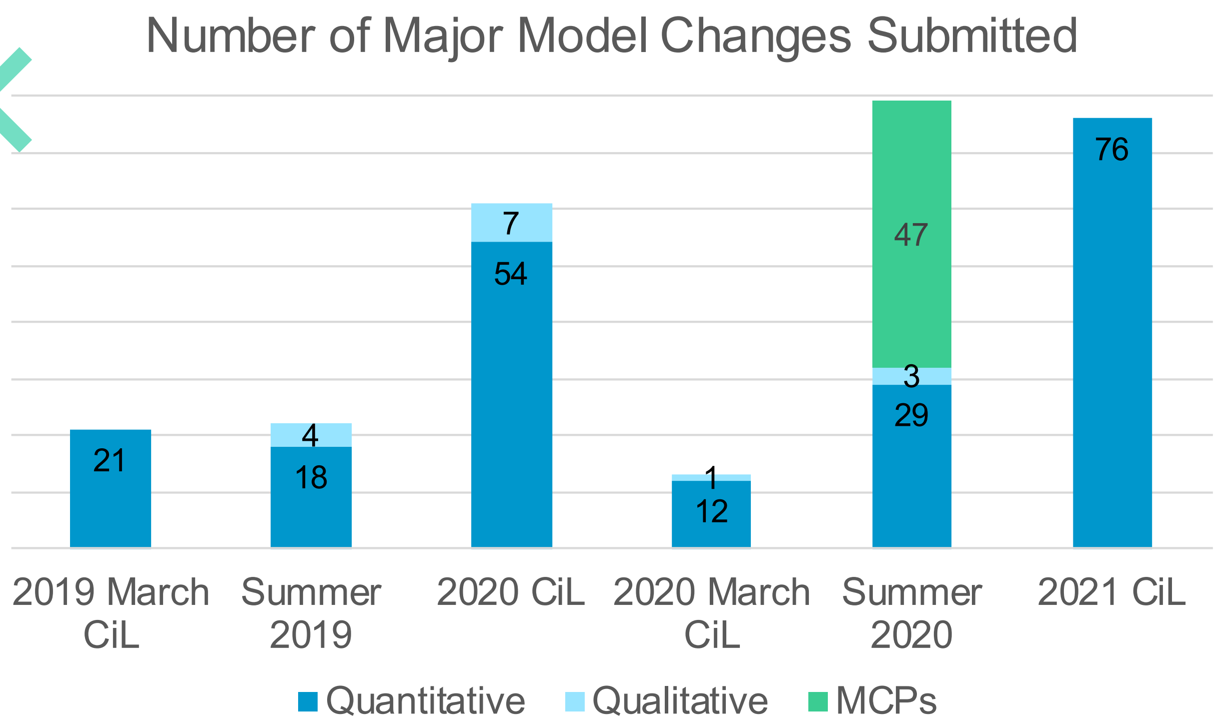
2. Increase efficiency of the process – streamlining

- MCT submission now only required with LCR submission
- LCR submissions now required with MMCs – more effort for MMC, but less on LCR reviews
- Internally alignment of MMC reviews and LCR reviews, same CPG escalation processes
- Capital will be reviewed from the last LCR submission, being from either an SCR or MMC submission
- **17th June 2021** deadline for summer MMCs, instead of end of June – to allow time to address feedback ahead of September submissions, as requested by agents
- Confirmation that prior feedback and any capital loads, should be addressed before submitting a major model change. Failing to do so may mean the application is not accepted

New Model Change Guidance now fully in force

Main objectives of new model change guidance were:

3. **Reduce number of MMC applications with submissions (and deferral of MMCs)**
   – About same proportion of MMCs deferred as 2020 – however – volume of MMCs higher
   – Deferred MMCs in general: accumulation of minor changes and not for material syndicates



Updated Guidance leading to improved submissions

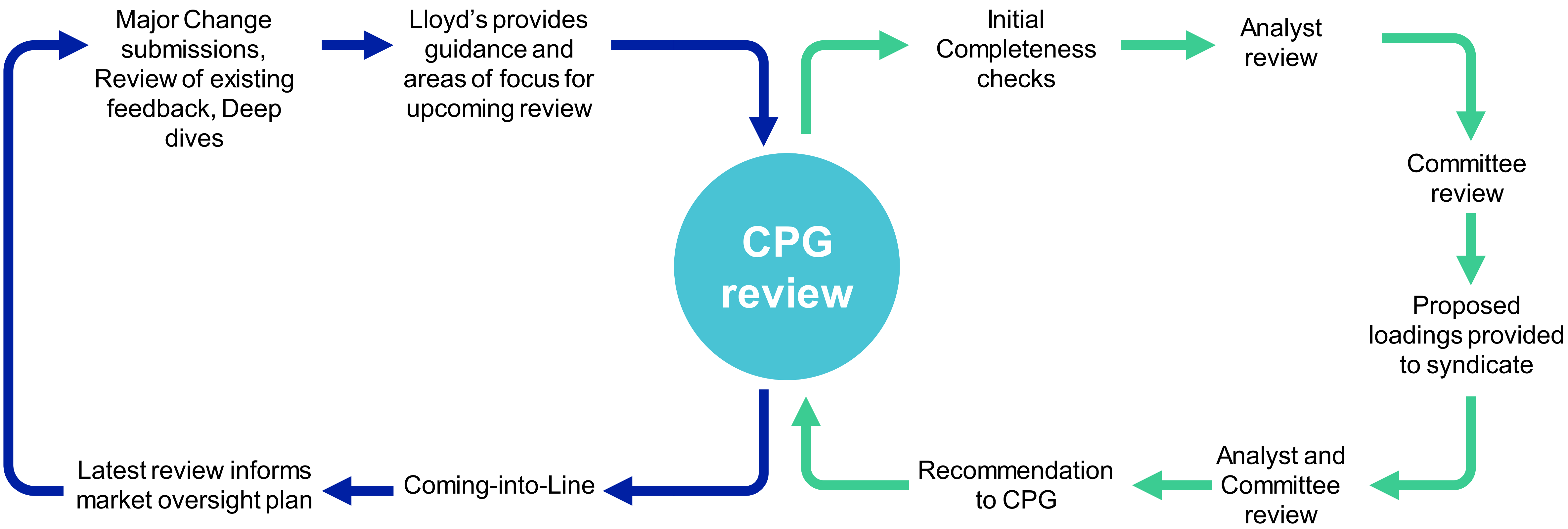
New Capital Guidance and Form 600 (Analysis of Change)

- Consolidation of all prior guidance in one overarching document
- Clarification on a number of areas (e.g. simulation error, allocation of discounting benefit)
- Some minor changes (e.g. time horizons for minor risk types, allocation of dispute risk, minimum requirements for correlations)
- Additional detail in the risk sections (e.g. operational risk and dependencies)
- Further clarity on process (e.g. LCR resubmissions following SBF resubmissions, March resubs)
- More detail on requirements like new syndicates, RITCs
- New requirement for Analysis of Change document. Revamp of form 600 in order to be in line with Lloyd's review

Improvements in submissions seen, further detailed feedback given

Fast Track Pilot implemented in 2020

Target: Moving to a more year-round process and improved predictability of capital setting



Fast Track Pilot implemented in 2020

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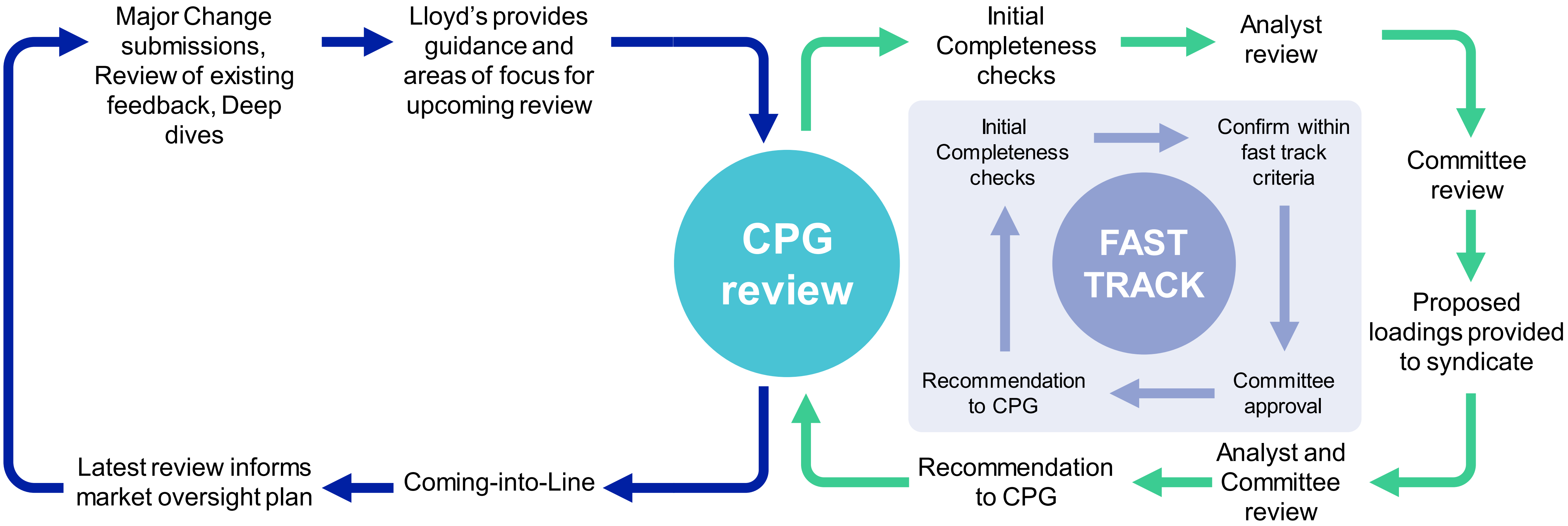

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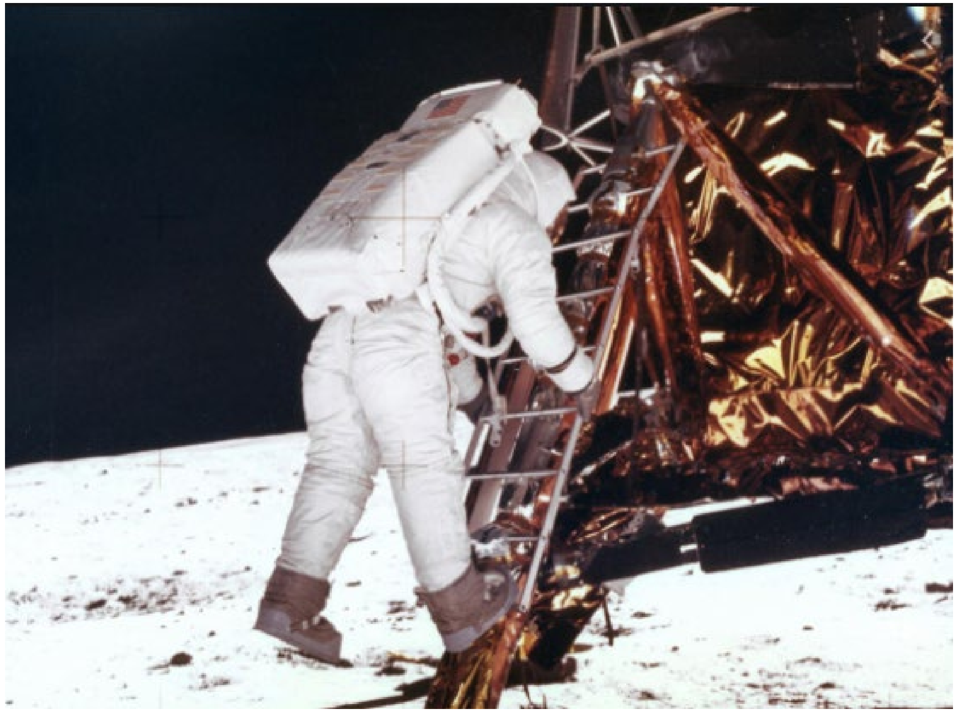
Success of the Fast Track Pilot

Target: Moving to a more year-round process and improved predictability of capital setting

Mixed – 17 syndicates were part of the pilot but just over half were removed from Fast-Track following the MMC



- Varying reasons like rejected platform changes, unresolved feedback/issues after MMC, further feedback following the deep dive.
- The remaining syndicates received light reviews unless they submitted a further MMC.
- Even if removed from fast track – review was still sped up/easier – effort not lost
- **2020: One small step for Fast Track**
- **2021: A giant leap towards continual review process?**

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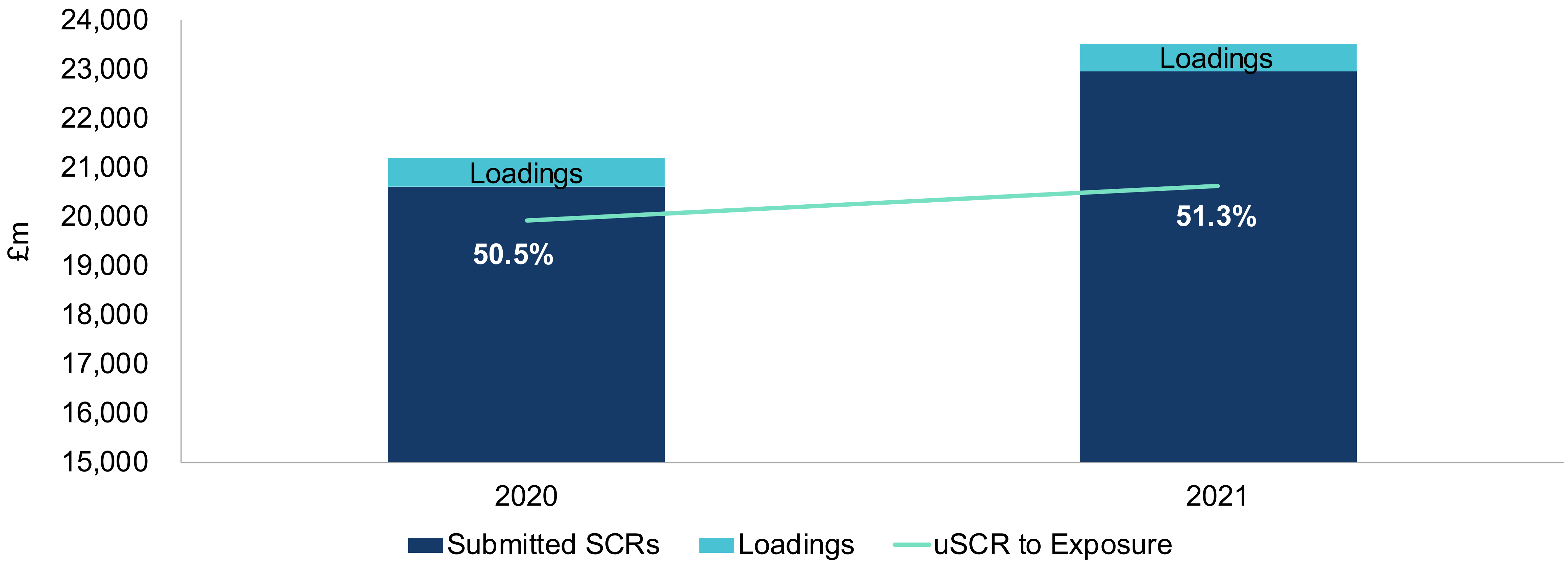
2021 SCR reviews

Cameron Beveridge

Senior Actuary

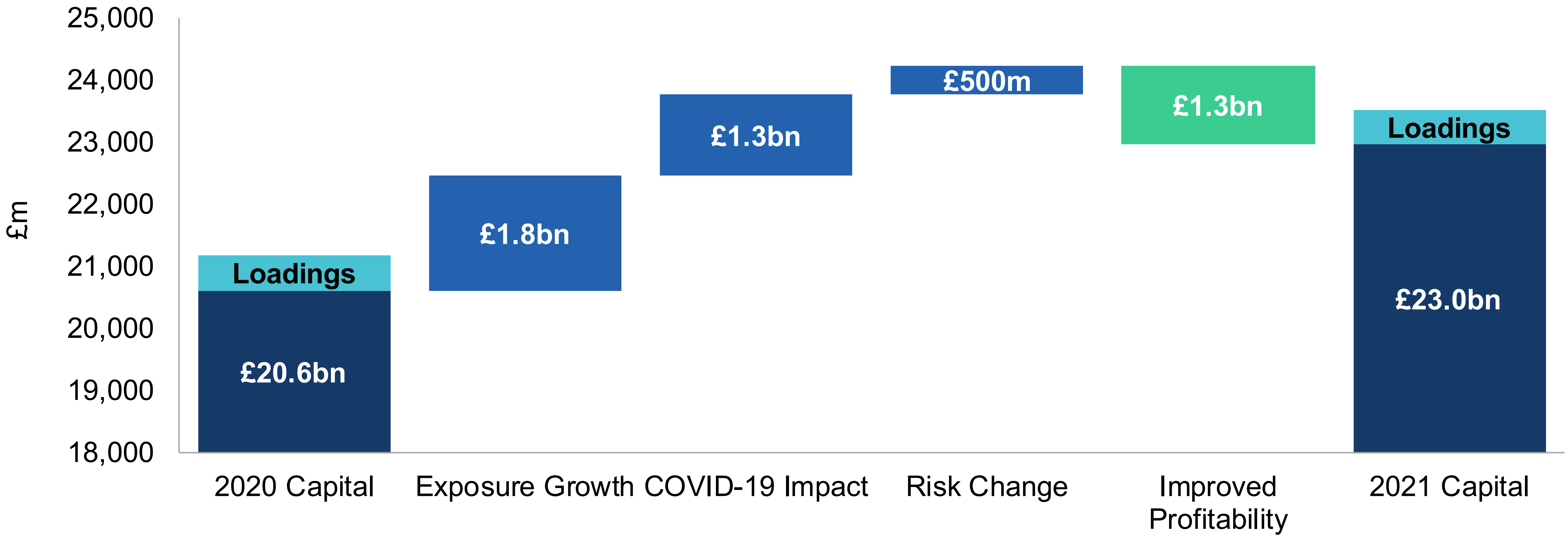
Required capital represents an increase on 2020

And increase in risk: exposure as expected



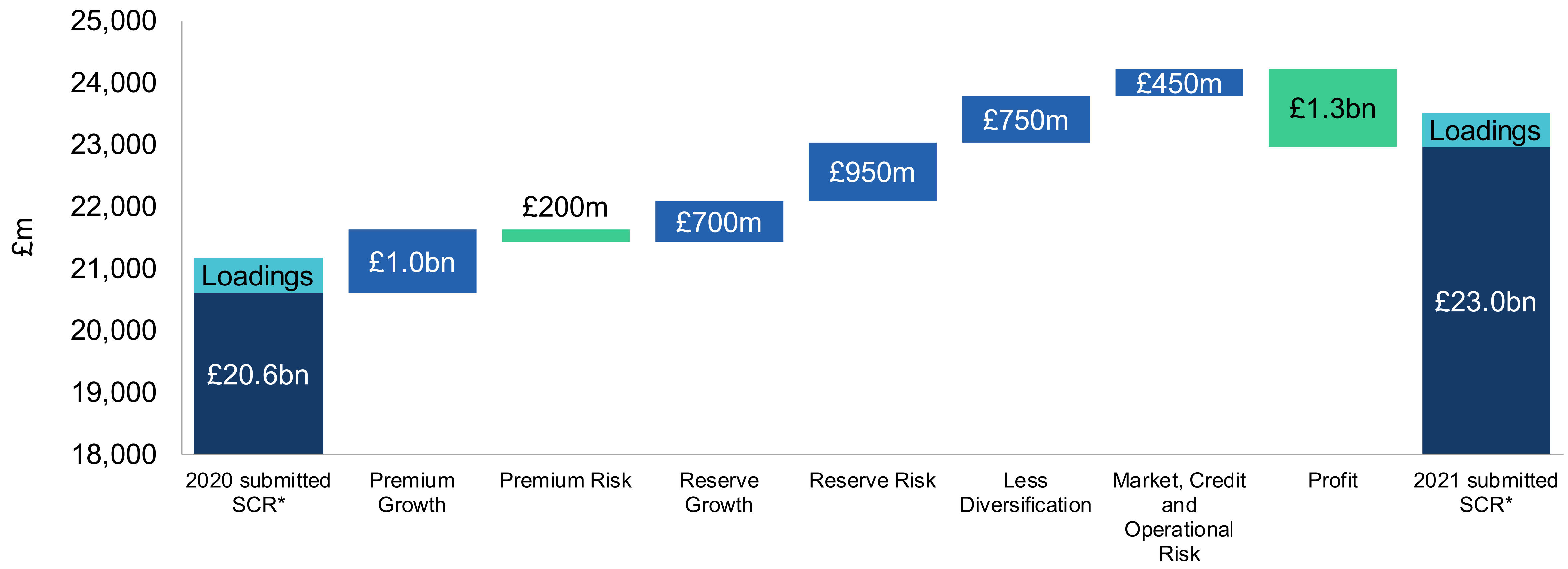
*Exposure defined as Ultimate Premium Risk Mean Net Claims +1/2 earned reserves (as per Form 600)

Movement in capital is driven by a combination of planned growth and impact of COVID-19



Breakdown of overall submitted SCRs

Capital increases with exposure growth and increased view of risk offset by higher profit



*submitted SCRs includes RICB adjustment

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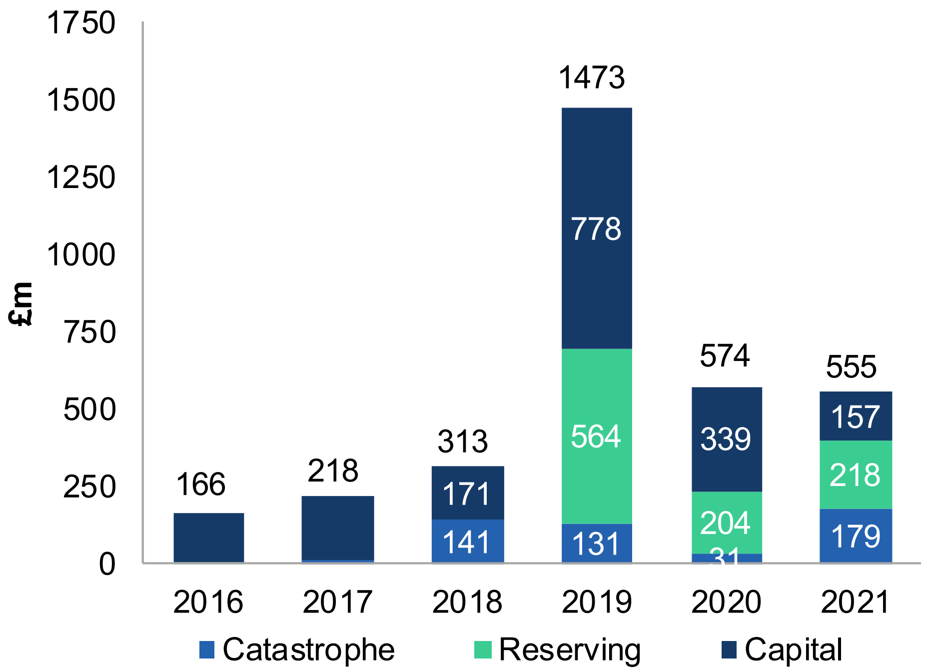
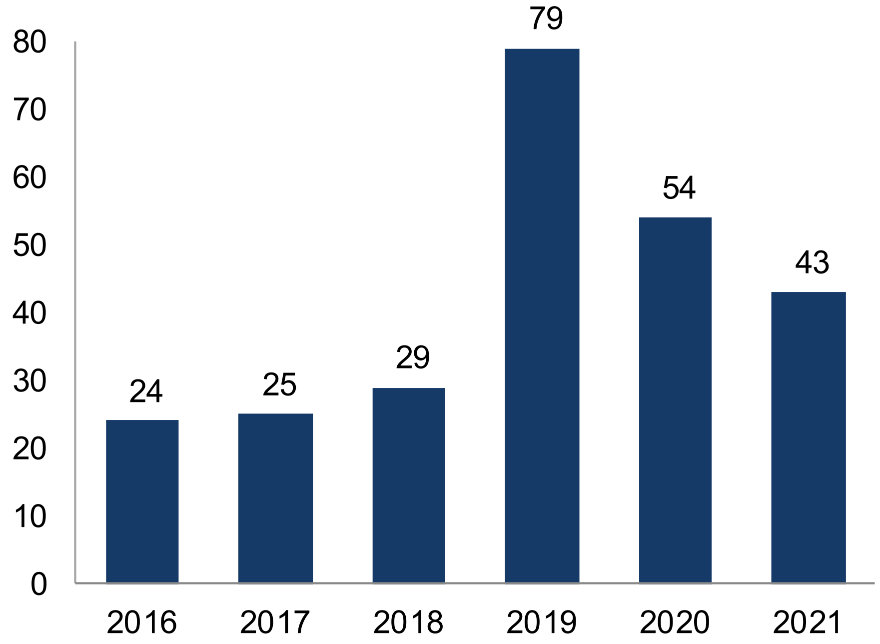
A similar amount of loadings have been applied for 2021

- With the lowest 'capital' loadings in 4 years

£m Ultimate Loading



No. of Syndicates



… applied to a fewer number of syndicates

– Less 'capital' loadings and higher catastrophe loadings

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Loadings applied across a range of risk areas

Reminder: 2021 loads approximately similar size to 2020

2020 Reviews | **2021 Reviews**

- Prospective loss ratio assumptions still most significant driver in terms of amounts of loadings, and increase in proportion
- Large increase in catastrophe loadings
- COVID – only 5 syndicates loaded across variety of areas

Quality of submissions and responses has an impact on the final outcome

- In many cases, indicative loadings (and final loadings) are determined by whether submissions are appropriately justified and validated. Common areas
  - Unexplained movements in smaller risk types
    - Model cannot be inherently unstable
    - Agents required to ensure post-diversification contribution is reasonable and reflects the risk profile of the syndicate
  - Minimum levels of dependency required between many model components
    - Exact approach not prescribed
- In Analysis of Change feedback, the above points were common feedback points

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COVID-19 reviews

Mirjam Spies

Senior Manager, Syndicate Capital

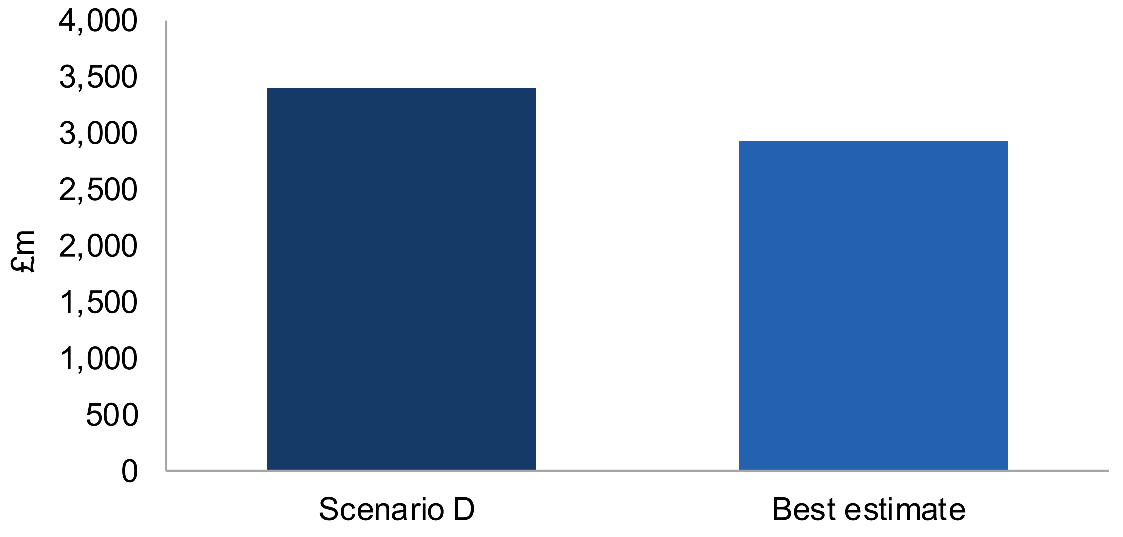
Why COVID-19 is different

COVID-19 is an insurance event with uncertain consequences over the medium-term outlook

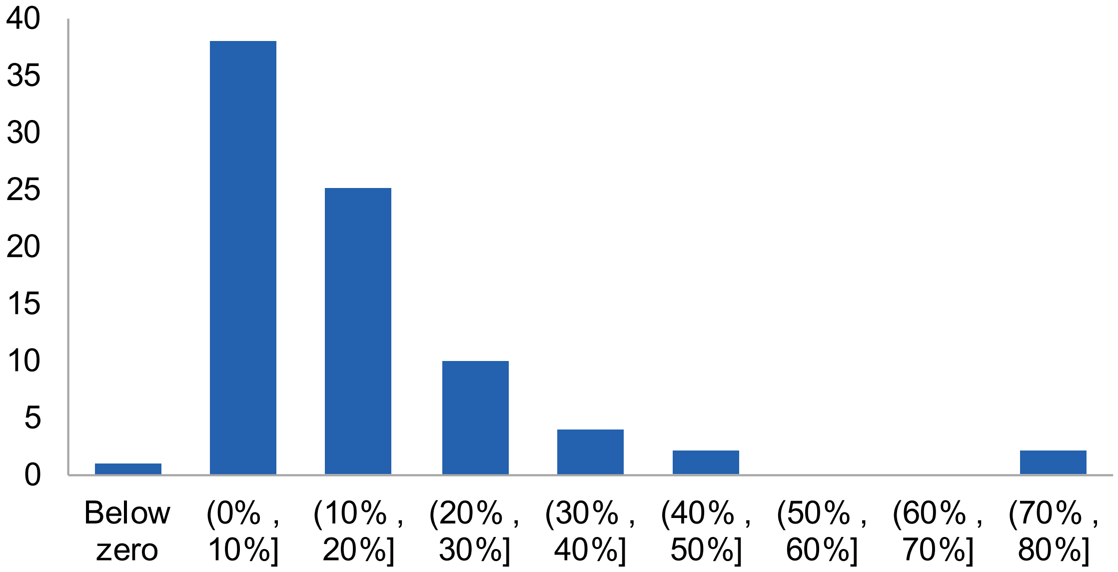
- A “grey swan” event – pandemic was on the radar but the effects of lockdowns on general insurance were not generally considered
- “Normal” catastrophe events are “point in time” events – which means at the point of capital-setting they are in the past and requirement is to reflect on whether the experience was adequately reflected in the model.
- **COVID-19 makes this significantly more complicated:**
  - How to model the ongoing (temporary) effects
  - Impact on multitude of risk areas
  - Not every model was able to cope without model changes
- **COVID-19 also made review of capital submissions more complicated:**
  - COVID-19 impacts were reviewed for ALL syndicates
  - Setting expectations clearly on the requirements for syndicates (Focus Area return and SCR instructions)
  - Develop consistent review framework.

COVID-19: Market Data

Premium risk losses



Total Losses as % uSCR



- Best Estimates reduced by c£500m from Scenario D (from April 2020 MCR)
- Scenario D based on social distancing, restrictions until 30 September 2020

- Experience varied across the market between insignificant and material losses.
- Proportionality principle in response

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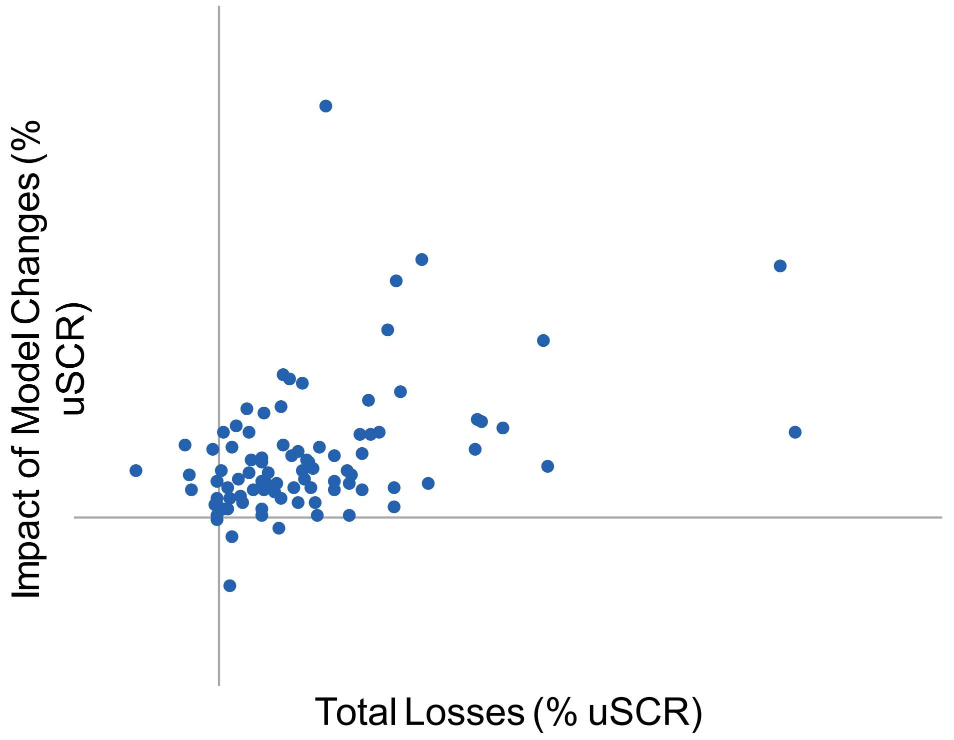
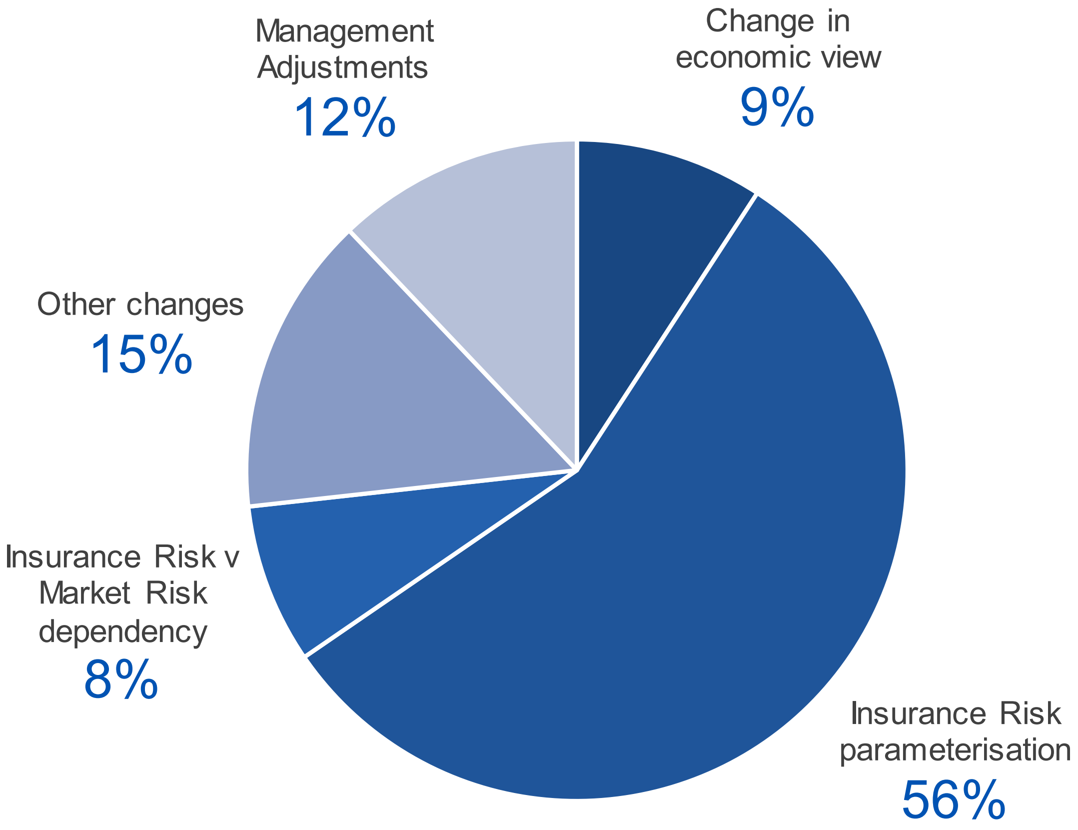
COVID-19: Active and engaged response from the market

Material adjustments across a range of model areas

Total Losses vs Model Changes (% uSCR)



Ultimate Capital Impact of COVID-19 Related Modelling Changes



Summary of Lloyd’s COVID-19 requirements for syndicates

Determine the direct impacts, and the secondary effects of COVID-19

Determine the direct impact due to COVID-19

Data collection of 3 types of losses:

- Losses from Scenario D (social distancing until 30 September 2020) as per MCR
- Ultimate Best Estimate losses
- Asset impacts as at 31 March 2020 and 30 June 2020

These losses are split across affected classes, and syndicates were asked for BE ultimate return periods for each class

- Where losses are material, requirement for extra information on return periods
- Where class losses are worse than 1 in 20 in the 2020 model, further questions on actions taken
  - E.g. exiting class, increasing loss ratio / volatility
  - Expectation of something to change

Consider wider impacts on capital modelling

Managing agents should make temporary model changes:

- Updating yield curves & other known data
- Heightened probability of entering a recession
- Increased RI Credit Risk due to downgrades/defaults
- Operational risks of full-time work-from-home

Definition of “temporary model changes” quite varied across respondents

COVID-19 as a near miss

- What could have happened differently?

What other events may have similar impacts?

- Recessions
- Prolonged cyber attacks
- Climate change
- Further pandemics
- Other global lockdowns

These requirements were then translated into a rule-based review framework.

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COVID-19: Review framework

Development of a review framework. Aims:

- Consistency of review across syndicates – in particular with regards to loadings
- Efficient to enable us to review all syndicates
- Mix of rules-based approach and qualitative review
- Proportional to COVID losses and materiality of areas in question

Starting questions:

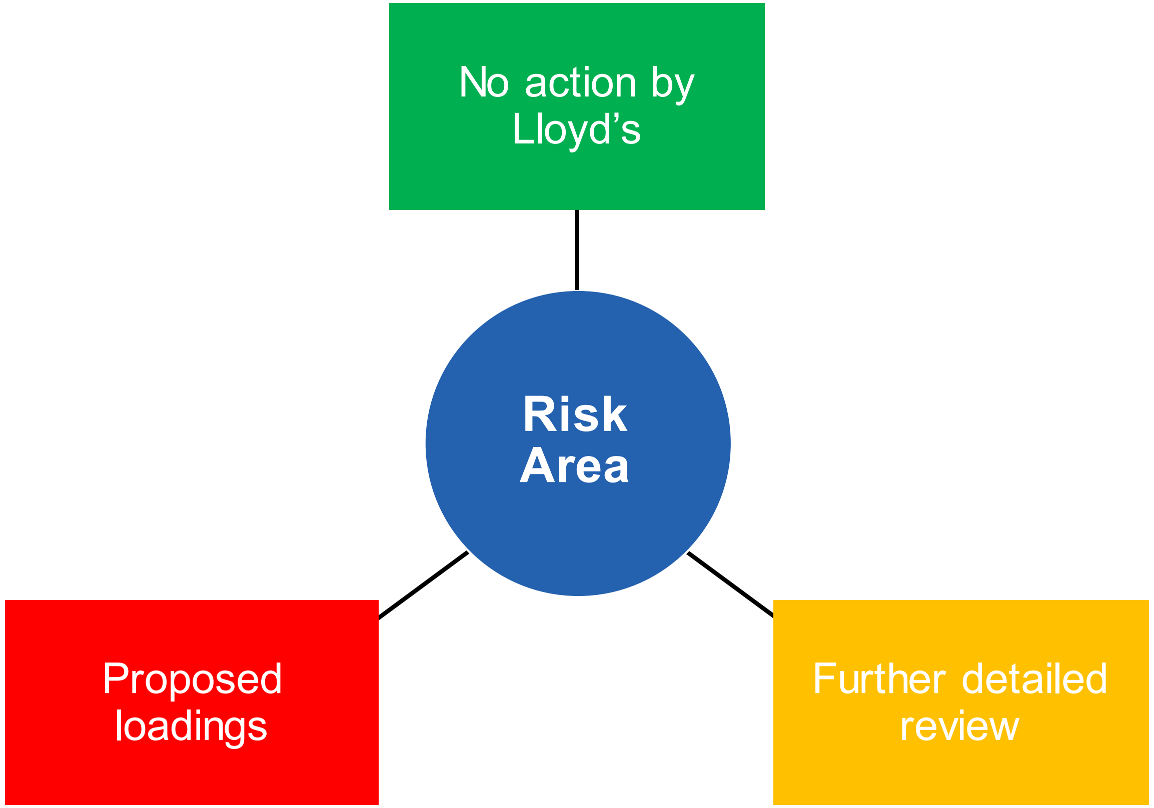
- Has the area been considered?
- Were there material losses in the area

RAG rating for each area depending on combination of the losses in the area (e.g. premium risk) AND the response to the question

- **GREEN rating:** no further action required
- **AMBER rating:** detailed qualitative review of response given (documents on COVID, validation report) then downgrading to Green or upgrading to red or feedback given.
- **RED rating:** detailed qualitative review of response given. Potential downgrading but in general loading proposed

COVID-19 Response

Structure for next slides



Stats showing the % of responses for each drop down option on Focus area return.

Split into a RAG rating where

- Losses >20% of uSCR
- Losses >=10% of uSCR
- Losses <10% of uSCR

★ Best Practice Implementations we have observed

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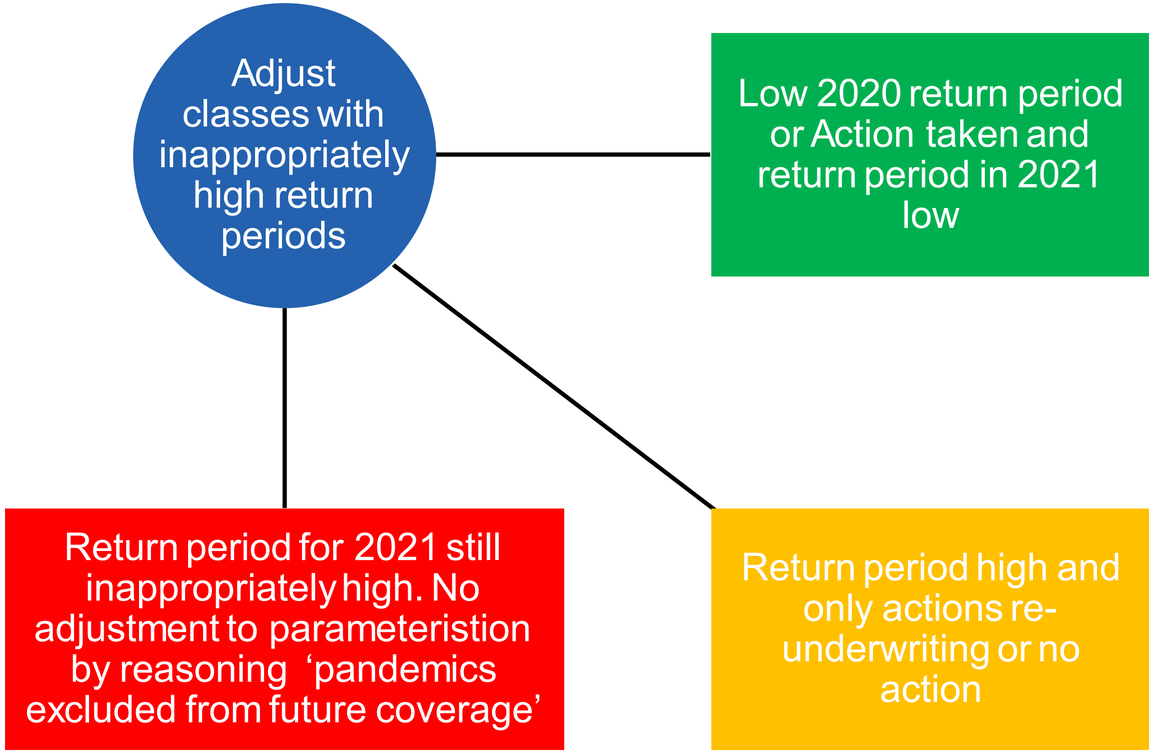
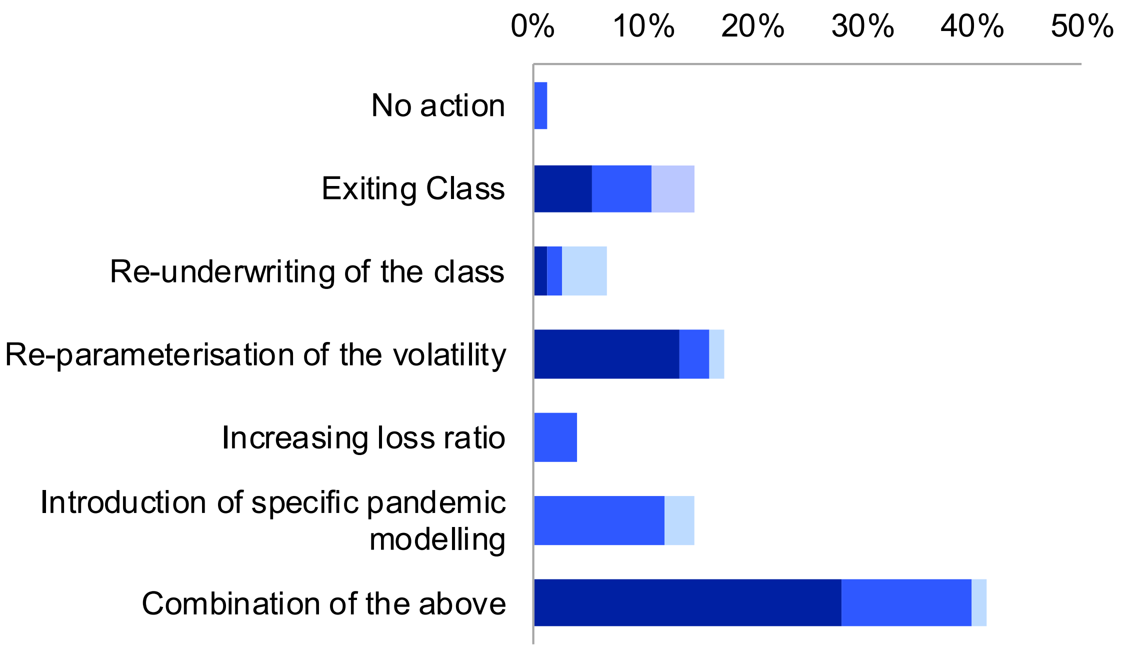
COVID-19 Response

Premium Risk



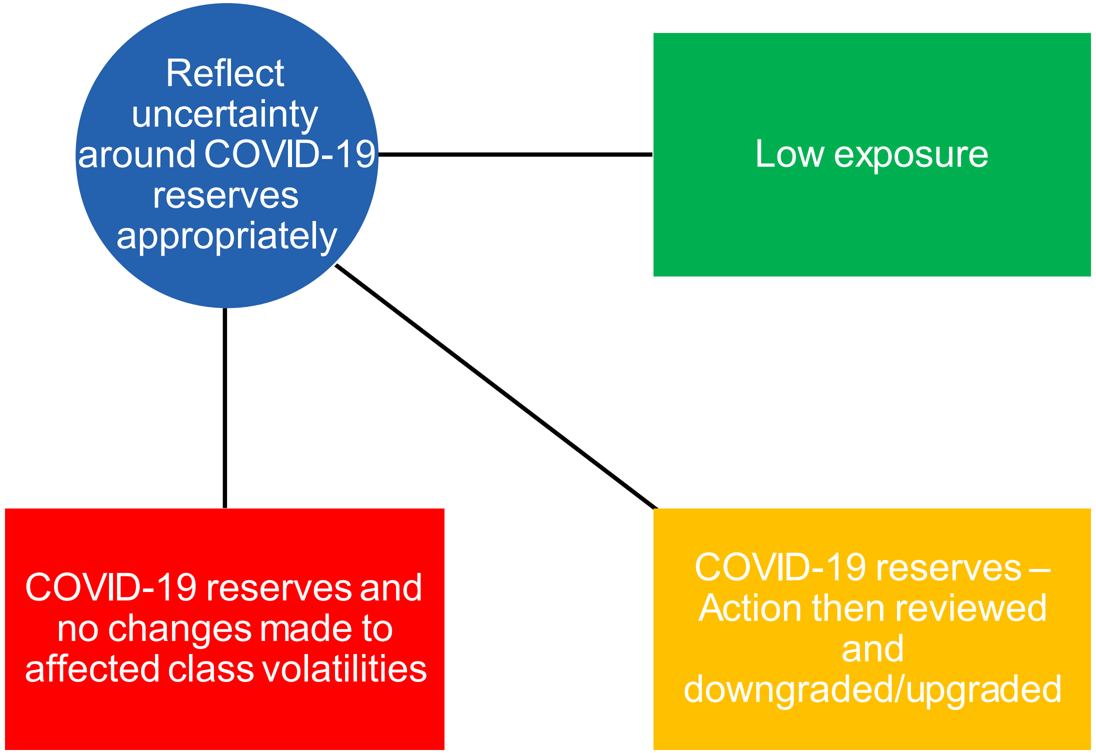
Actions taken on premium risk classes where return period was > 1 in 20 in 2020 model

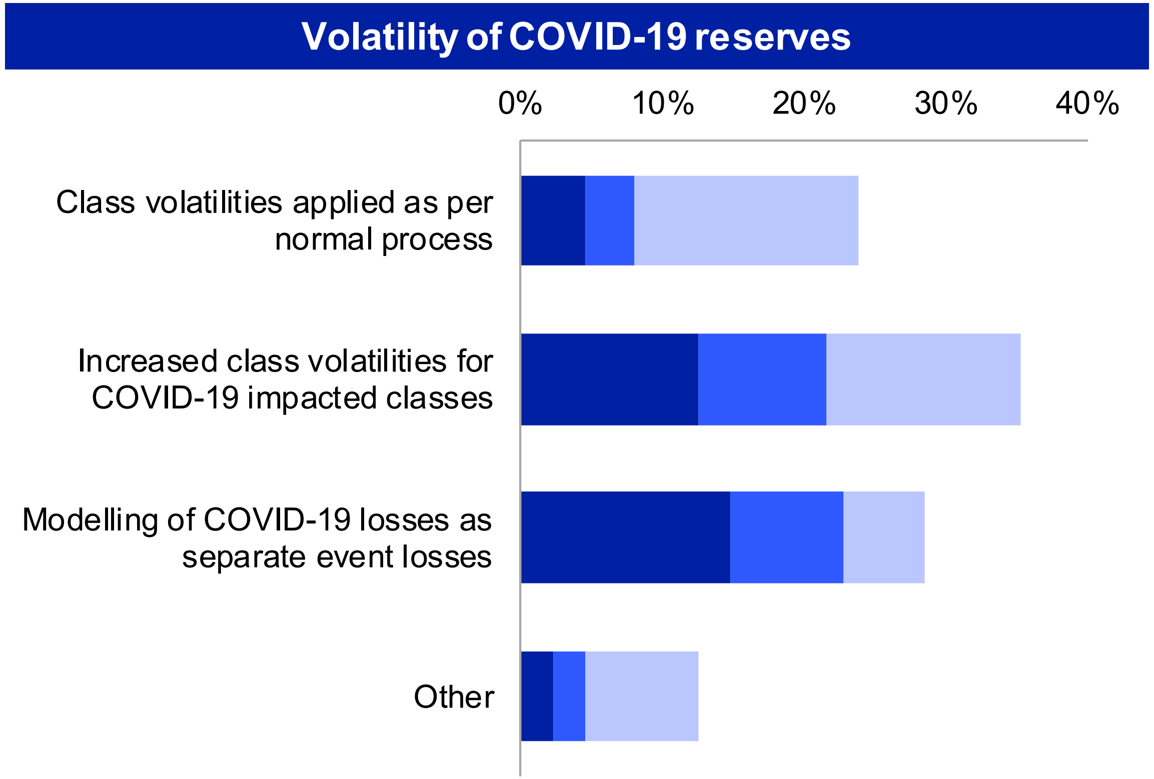


★ Implementation of pandemic driver affecting classes at once and/or economic downturn driver. Clear link of modelling to "real" world. Consideration of classes impacted by recession.

COVID-19 Response

Reserve Risk - How have you parameterised the volatility around COVID-19 related reserves?

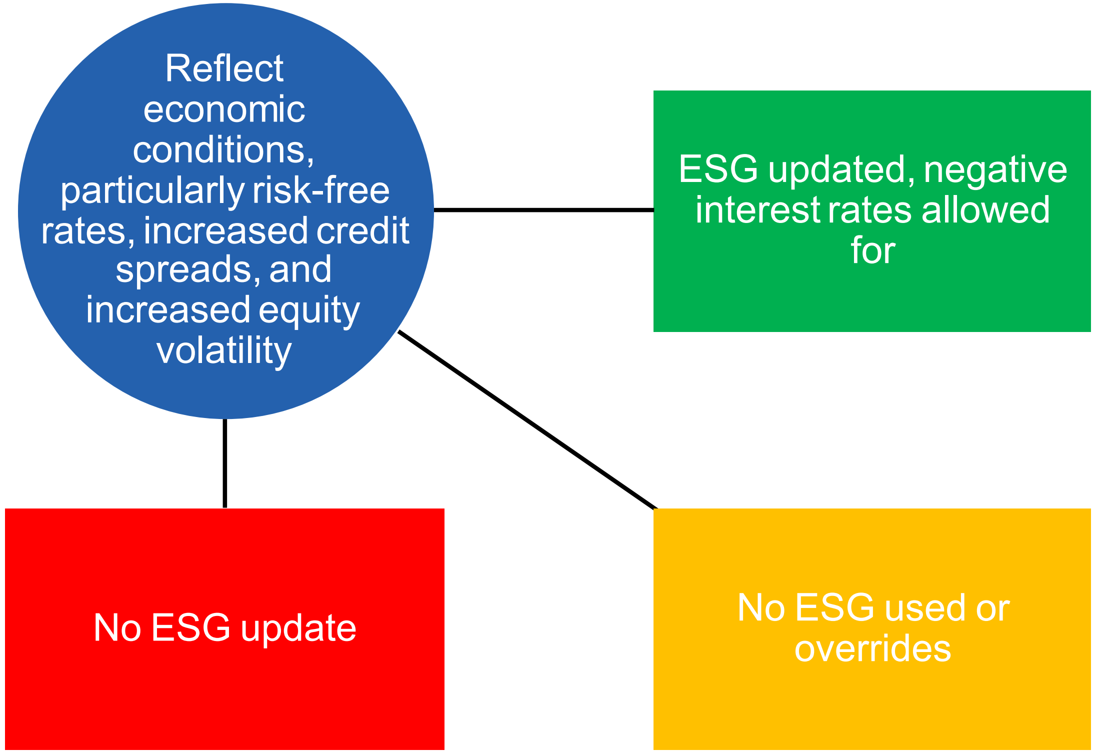


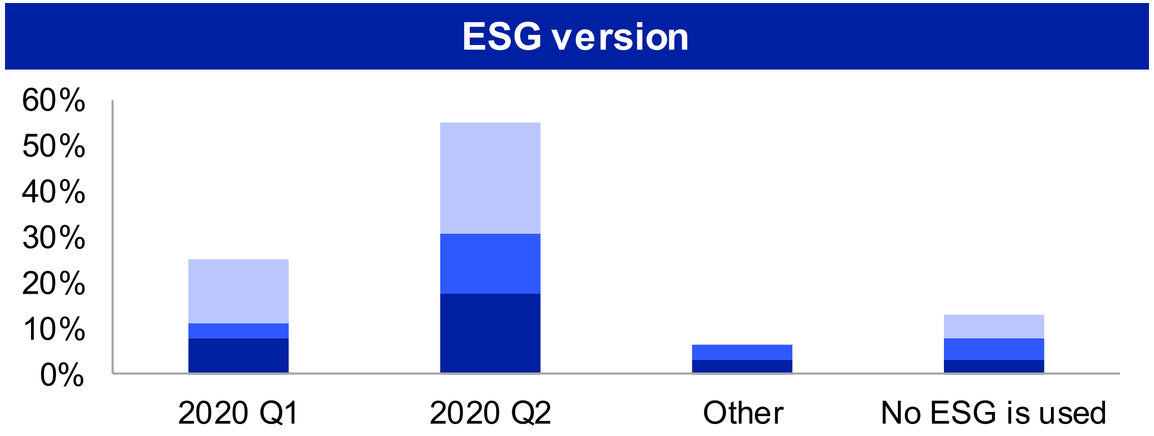


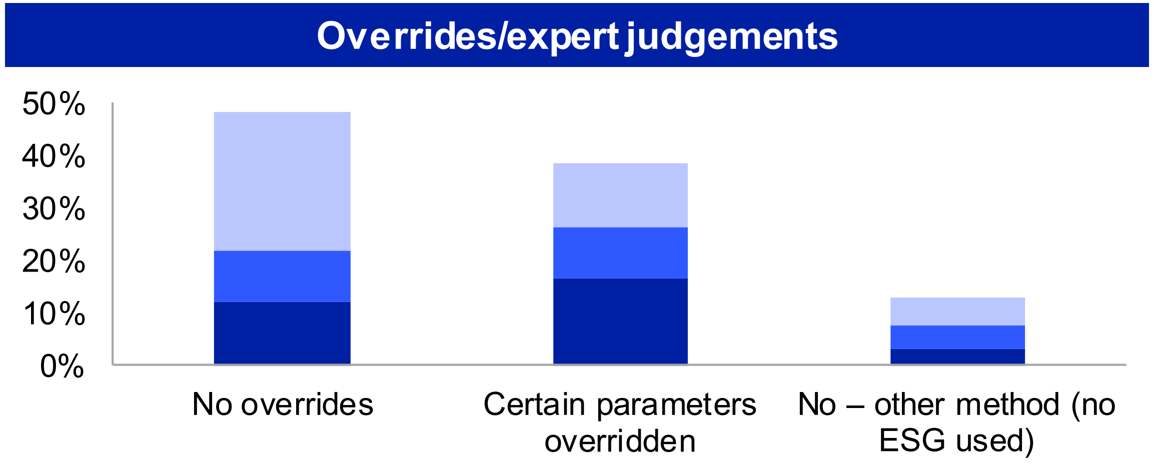
★ Scenario analysis and expert judgement on COVID reserves outlining probability and severity of several scenarios to inform parameterisation

COVID-19 Response

Market Risk







★ Explicit tailoring of parameters to reflect syndicate asset profile and asset/liability FX exposures

COVID-19 Response

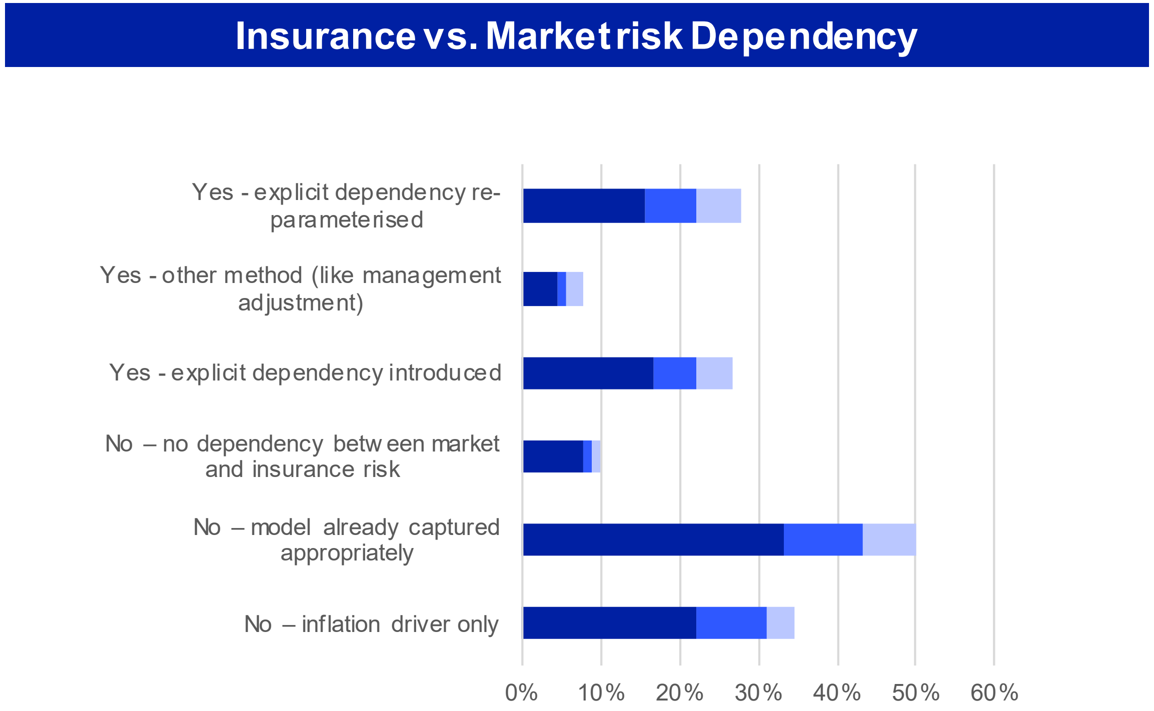
Dependency between Market Risk and Insurance Risk - Have you made any changes to the dependency between market and insurance risk in your model in light of recent events?

Consider the potential for deteriorating asset positions and insurance losses to be linked

At least inflation driver and low market risk losses or high market risk losses but driver implemented which has an impact

No dependency between insurance and market risk (not even inflation link) or dependency existent but low impact and high RP for 2021

Driver implemented but return period still significant for 2021



★ Explicit linking between credit spreads and Credit classes. Dependency modelled between FinPro classes and equity returns. Economic driver/Pandemic driver linking to market risk.

COVID-19 Response

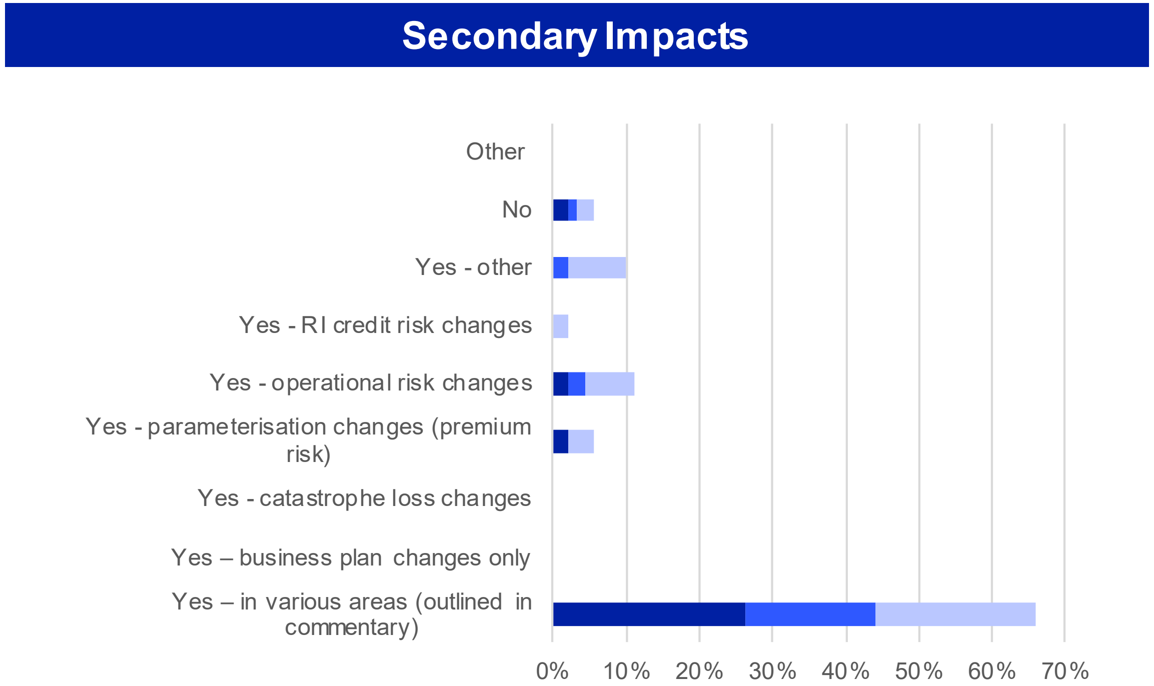
Secondary impacts

Appropriately reflect the secondary impacts of COVID-19

Most secondary impacts considered

Most secondary impacts considered with feedback on immaterial drivers

Some impacts not considered



COVID-19 Response

Secondary Impacts – Best Practice

Recessionary Impacts

- Loss ratio/volatility changes to economically exposed classes
- Uplifted dependencies between economically exposed classes
- Uplift of economic drivers

Credit Risk

- downgrade all reinsurers by one notch, increase to default rates, time delays

Operational Risk

- Inclusion of additional scenarios (Remote working, staff impairment due to pandemic)
- Review of existing scenarios, e.g. Cyber scenarios, pandemic scenario, policy wordings
- Good level of validation and evidence of discussion

COVID-19 Response

Worst Case Scenario

To consider uncertainty around

- Legal outcomes
- Further Lockdowns
- Mutations
- Political Changes

Weakest Area of Response

- Significant number of indicative loadings → indicative 5% of uSCR loading
- Derivation of PML not sufficiently explained
- Link between PML, uSCR, and return period not clear or consistent
- Differences between Focus Areas and underlying documentation

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Priorities for 2021

Mirjam Spies

Senior Manager, Syndicate Capital

Our focus will be on process improvements:

- Moving to a principles-based approach
- Fast track pilot to be boosted
- Model changes to be prioritised
- Only actual performance drives your capital
  - Prospective loss ratios
  - Continuous Monitoring of COVID experience

People and well-being

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Moving to a principles-based approach

Target: Assess model holistically

– Internal Models are inherently complicated

– CPG and capital reviews at year-end CIL occur over a relatively short window of time

– Our primary concerns:

  – That capital adequately reflects risk profile

  – Consistency in capital strength in the market

→ In 2021, we will embed clearer consideration of materiality in the review process.

– Reliance on your governance/validation/controls

– Detailed reviews outside the CPG process (see fast track)

→ You must clearly demonstrate how you have escalated and resolved validation findings, how you have addressed our feedback and how you have accounted for any limitations of the modelling (management actions).

Boosting Fast Track

Target: Minimising Review in Planning Season

Increase the pool of syndicates on fast track

- Include run-offs
- Remove optionality
- Require LCR submissions as part of model changes

Ensure more syndicates remain on fast track

- Feedback/prior loadings need to be addressed as part of major model change applications
- Any rejection of MMCs will be communicated as soon as possible – introduce go/no go checkpoints

Prioritising Model Changes

Target: Optimising Interdependence between MMC Application Review and Fast Track

Optimising Timing of Major Model Change applications

- Deadline brought forward to enable feedback to be addressed in time for CPG review season
- Accumulation of minor changes should be submitted when they occur

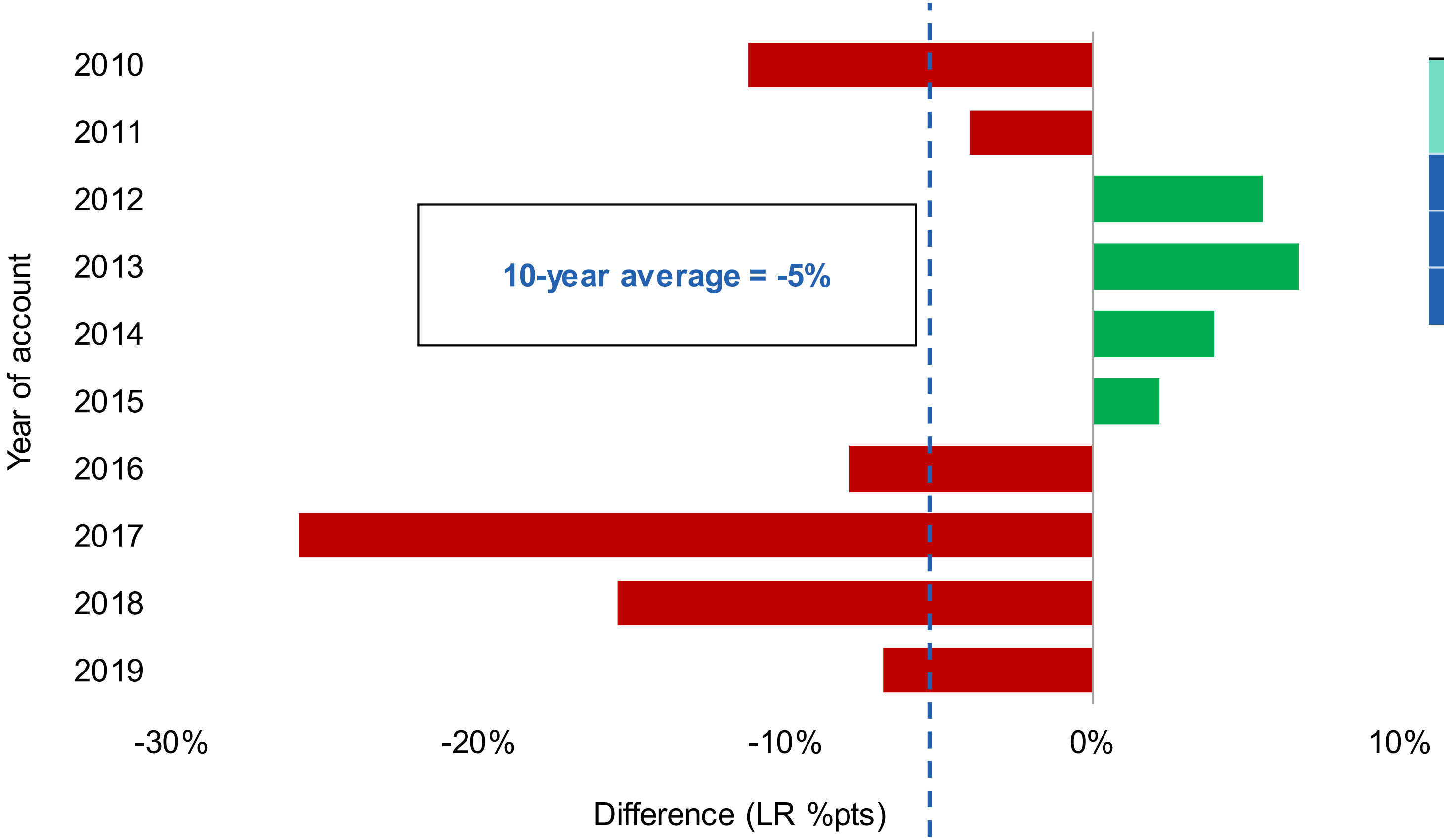
Major model change plans in advance in future

- Prioritising “non-essential” major model changes
- Tie model change reviews in with model deep dives as part of fast track

Only actual performance drives your capital

Prospective Loss Ratios - Plans continue to look ambitious against track record

Difference between plan loss ratio and Lloyd's ultimate loss ratio



Combined Ratio

	SBF to model self-load	Lloyd's uplift	Total uplift
2019	1.0%	1.5%	2.5%
2020	2.5%	0.4%	2.9%
2021	2.8%	0.5%	3.3%

NEW: Q1 2021 Modelled Loss Ratio review process

To determine if additional capital is needed

19 January: Details communicated via email to the market

Market Performance assessed on Q4 QMB results

Market performance better than defined threshold determined by Lloyd's

No further action

Market performance worse than defined threshold

Lloyd's will identify syndicates materially contributing to this result and consider if loading is required

If LCR submitted on 1 March as per usual mid-year CIL process, capital assessed in line with usual process

If LCR not resubmitted, loading considered in addition to usual mid-year adjustments

- Syndicates will not be loaded for loss ratio deteriorations where the drivers of the deterioration are not expected to impact the 2021 modelled loss ratio
- Syndicate capital reassessed for the year-end position must consider appropriateness of modelled loss ratios in light of 2H 2020 experience
- Details communicated via email to the market on 19 January
- The purpose of this exercise is to prevent a central Lloyd's loading and ensure suitable central solvency

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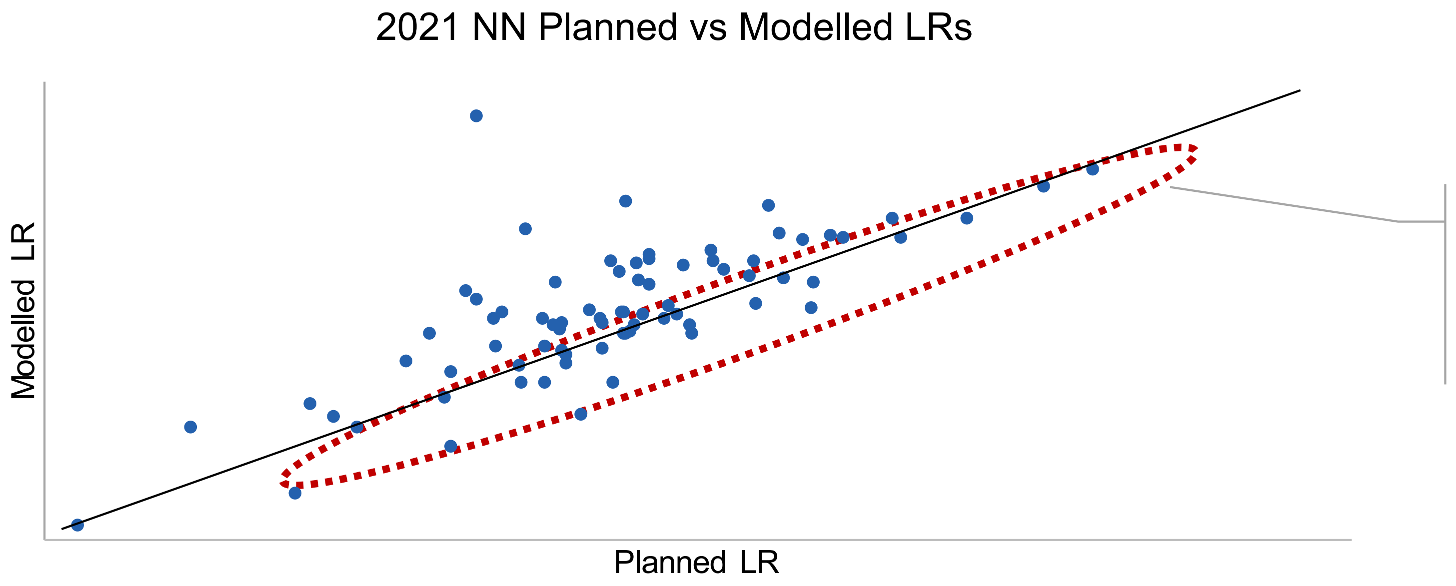
Proposed changes to Prospective Loss Ratio Test



Expected change to testing/guidance for 2022 Capital and Business Planning approval process

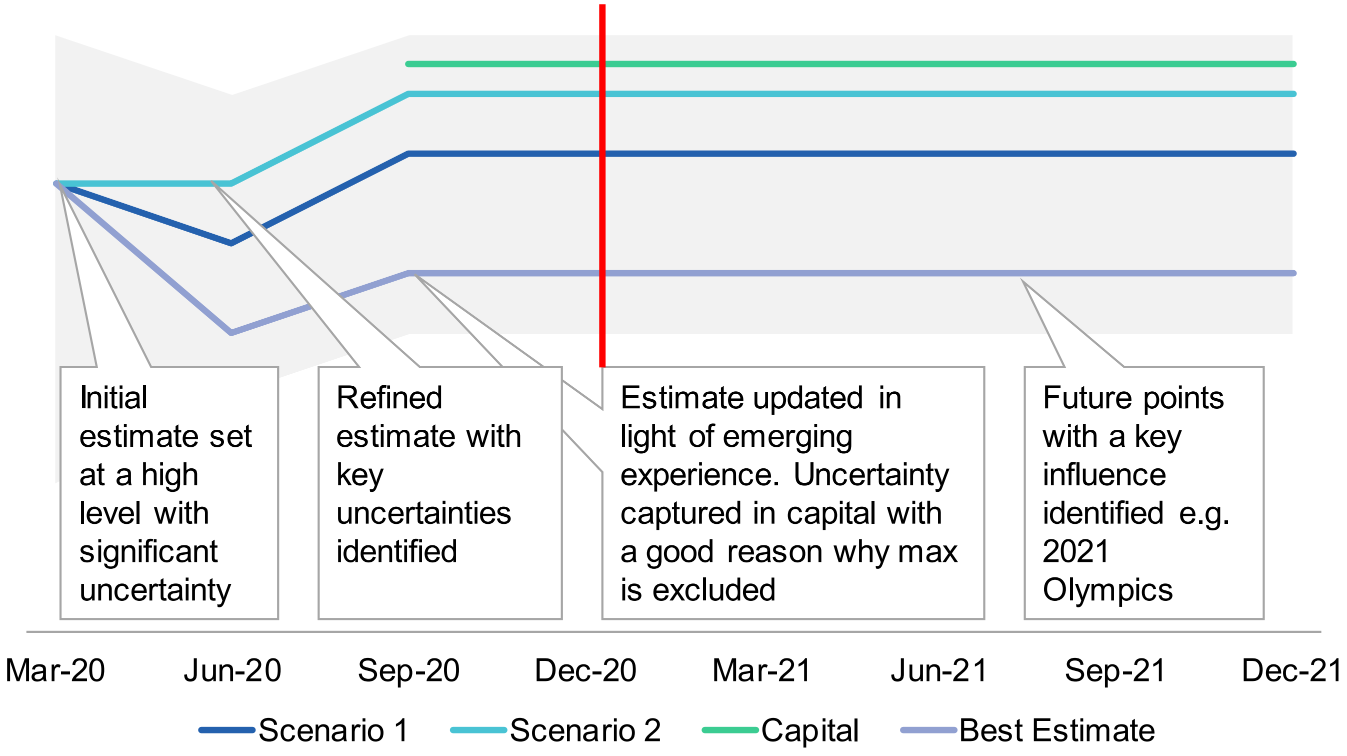
– Engagement with the market between the indicative formulaic assessment and the final CPG loading has led to an increase in allowable adjustments for 2021. This was expected given the extensive re-underwriting and change in the market cycle.

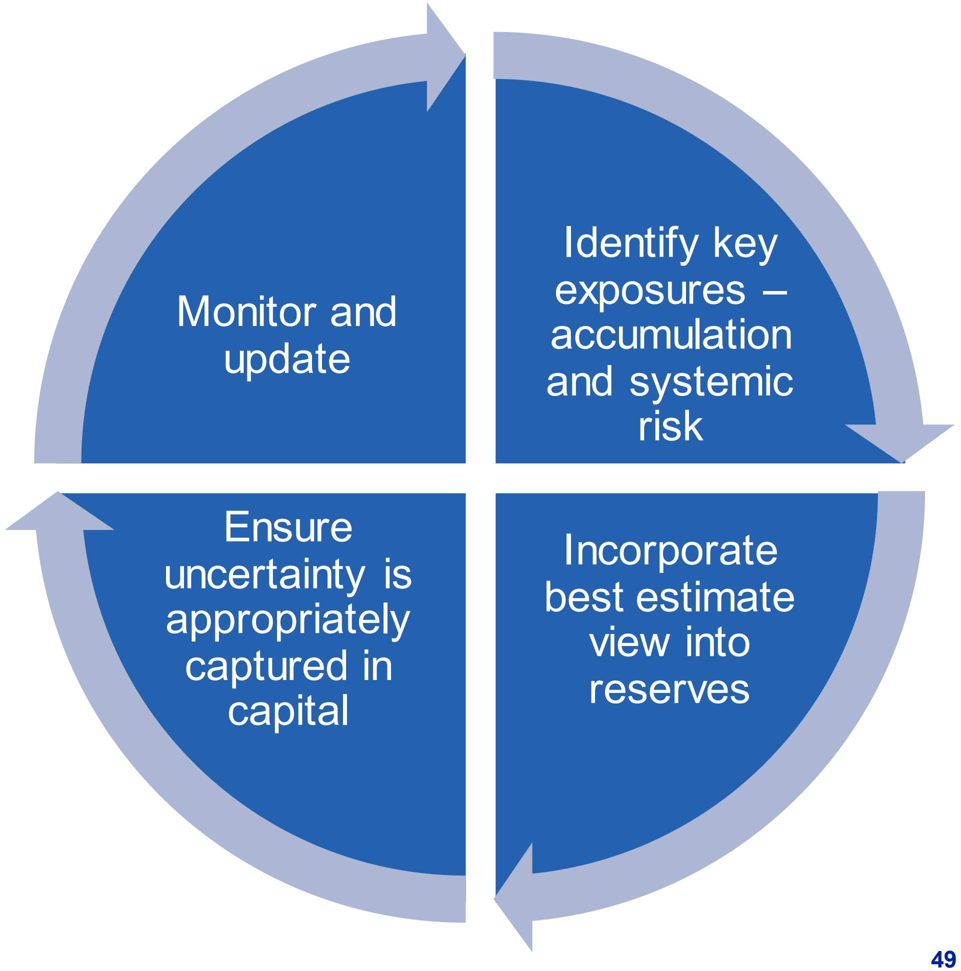
– Lloyd's is in the process of reassessing the testing framework for the Actual vs Plan test to address the impact of the current market conditions and will be engaging a focus group on potential updates/refinements

COVID-19: Ongoing monitoring is required

We accept this is a moving target, this means it requires joined-up monitoring

Covid 19 Loss Estimates





People and Well-Being

It's been a tough year – take care of your team

– Workloads for capital modelling teams were high in general last year - incorporating COVID experience led to a lot of "unplanned" major model changes and extra parameterisation work

Continuity of Teams – knowledge transfer

Prioritisation of your work

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Hot Topics and Working Groups in 2021

- Changes to the AvP test
- Claims inflation
- Non natural Catastrophes
- Working group on Focus Areas return for 2022

Feedback always welcome

Exposure Management

Thematic Areas of review for the 2021 YoA review

- Lloyd's Exposure Management are continuing to look at model completeness, i.e. potential "non-modelled" risks
- Climate change: we expect that natural catastrophe models should be validated as appropriate for **current climate conditions.**
  - i.e. not overly weighted to history
- Furthermore, there will be increased focus on non-natural and man-made catastrophes. The expectations are that methodologies for managing and modelling these risks are as robust as those used in modelling natural catastrophes.
- Exposure Management Minimum Standards have been updated to cover the above two points.
- Cyber and Liability scenarios will be collected again
- We expect agents to incorporate the work of their exposure management teams effectively into the capital modelling process

Timeline

Q1

- Capital briefing (9 February)
- Deferred Major Model Changes (plus greater volume RITCs than prior years)
- Q1 2021 model loss ratio template. Sections A & B, all syndicates (16 February). Targeted syndicates, sections C & D (24 February)
- Validation critical feedback responses (19 February)
- IMO returns (15 February)
- March reassessment templates and where necessary, MY CIL LCR resubmissions and March Focus Areas template (1 March)
- Fast track requirements reviewed

Q2

- Making It Happen and Solvency II compliance reviews (announced in oversight letters)
- Communication of syndicates selected for deep dives/Fast Track (linked to MMCs where possible)
- Validation briefing (11 May)
- Capital Market messages (TBC)
- Claims inflation study (data request – announced in oversight letters)
- Capital guidance and LCR instructions published (no material changes expected to guidance)
- Assessment of Reserving Thematic tests of uncertainty, update on timelines and market engagement

Q3

- NED Forum (TBC)
- LCR submissions begin– Fast Track in place
- Exposure management model completeness return
- Exposure management return on 3 new Cyber scenarios added to formal RDS framework at RDL (in-force 1/7/2020 exposures) and collected in Form 452 of 2022 SBF (projected exposures)

Time for questions

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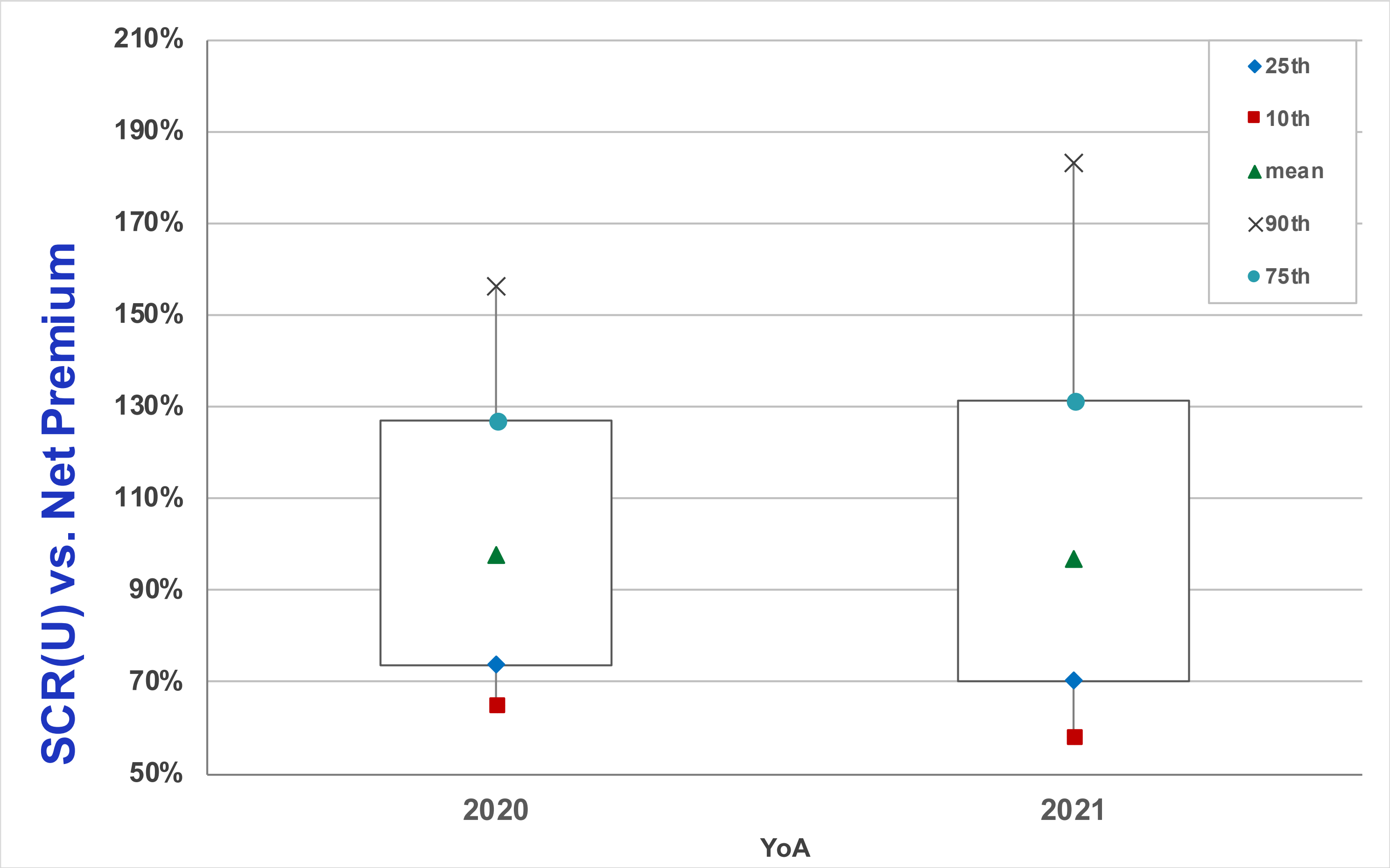
LLOYD'S

Appendices

Ultimate SCR vs. net premium

Excludes loads and other adjustments

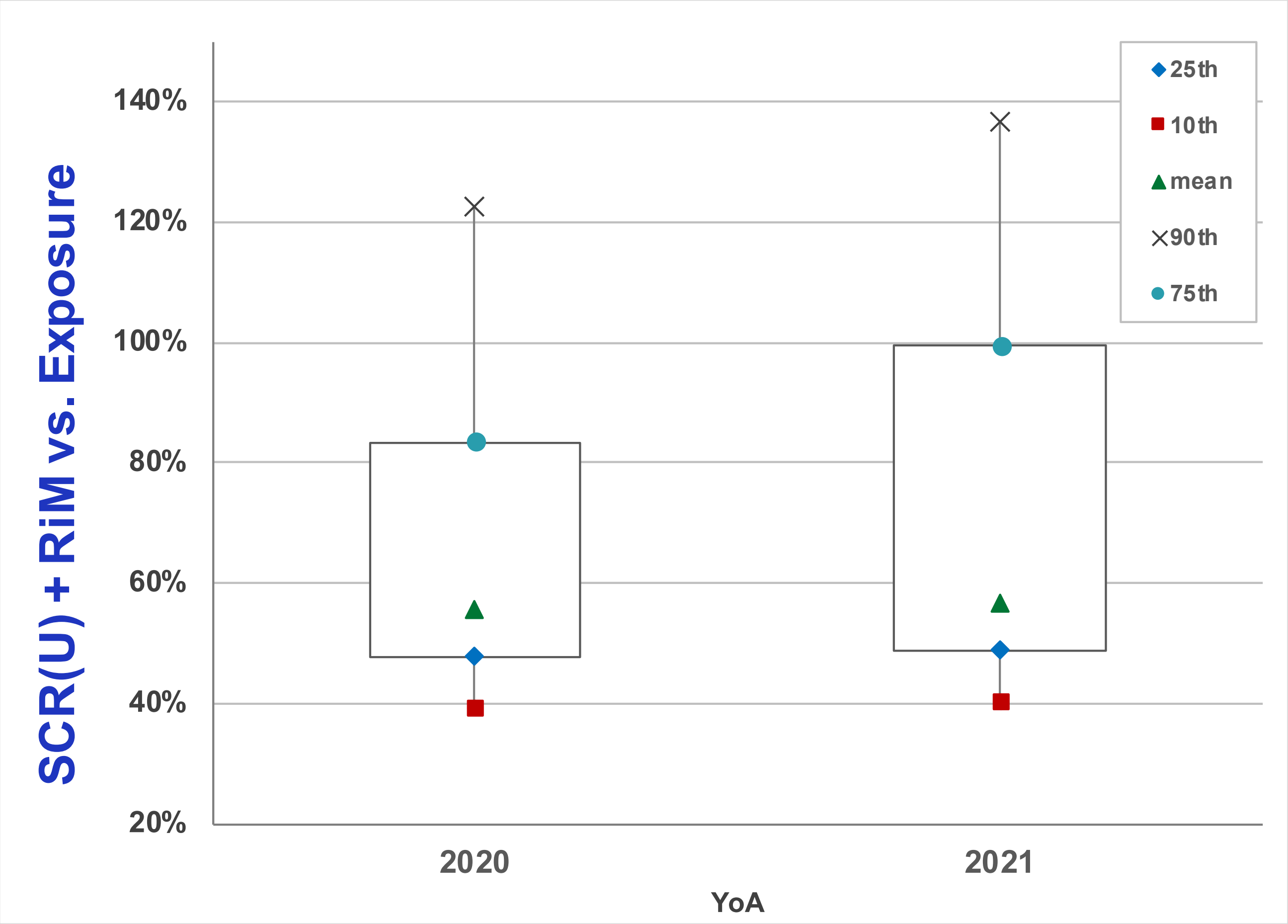


Ult SCR: F309 (submitted uSCR + management adjustments).

Net PI: F313 table 1 col D row 1

Ultimate SCR + RiM vs. Exposure

Excludes loads and other adjustments



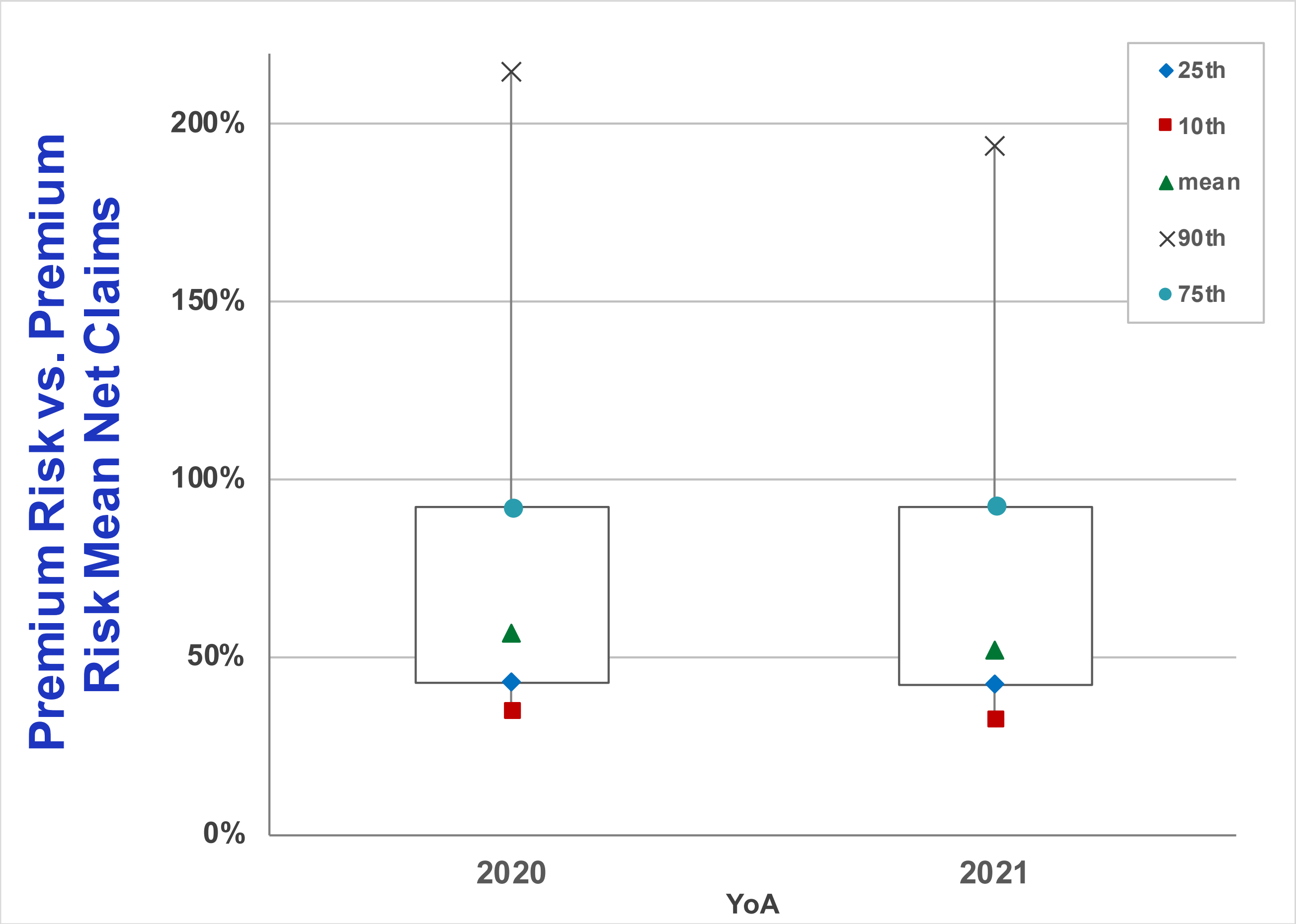
Ult SCR: F309 (submitted uSCR + management adjustments).

RIM: F312 col P total

Exposure: (LCR 313.3 H1 + LCR 313.3 H4) + (0.5 * LCR 313.3 H5)

LLOYD'S

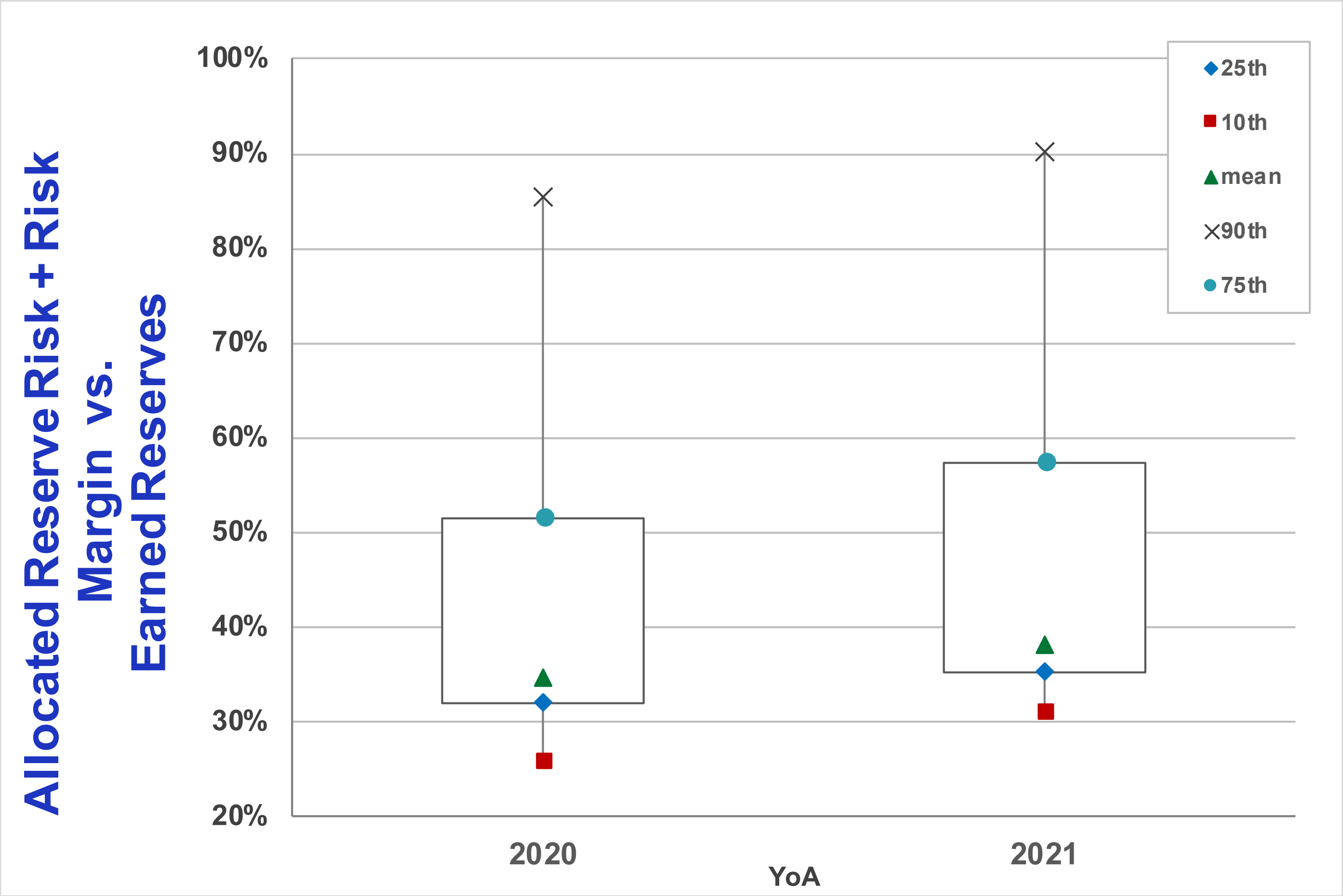
Premium Risk vs. Premium Risk Mean Claims



Ult premium risk (pre diversification): F309

Exposure: LCR 313.3 H1 + LCR 313.3 H4

Reserve Risk + Allocated RiM vs. Earned Reserves



Ult Reserve risk (pre diversification): F309

Risk Margin: F312 col P total

Earned Reserves: LCR 313.3 H5

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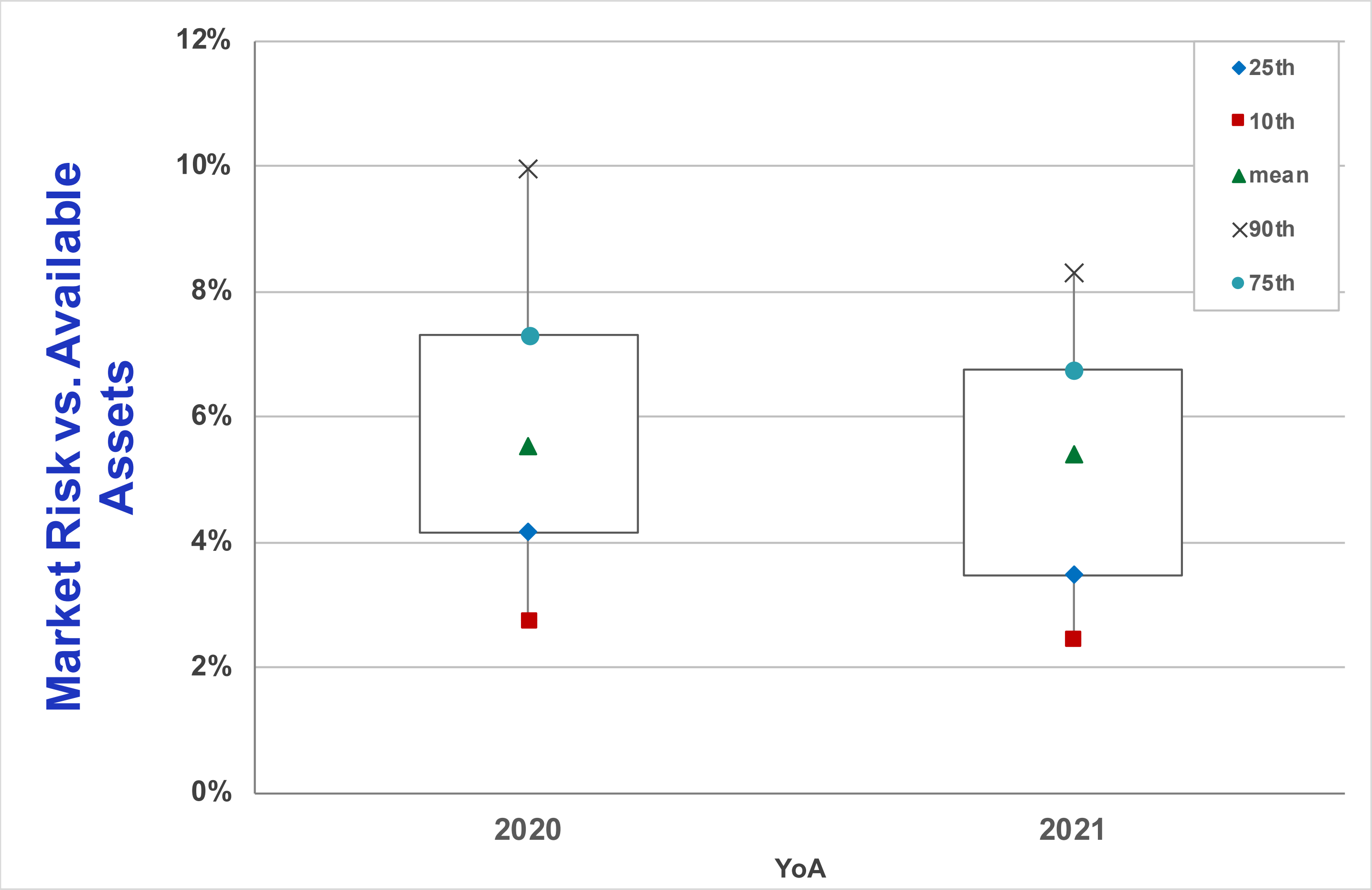
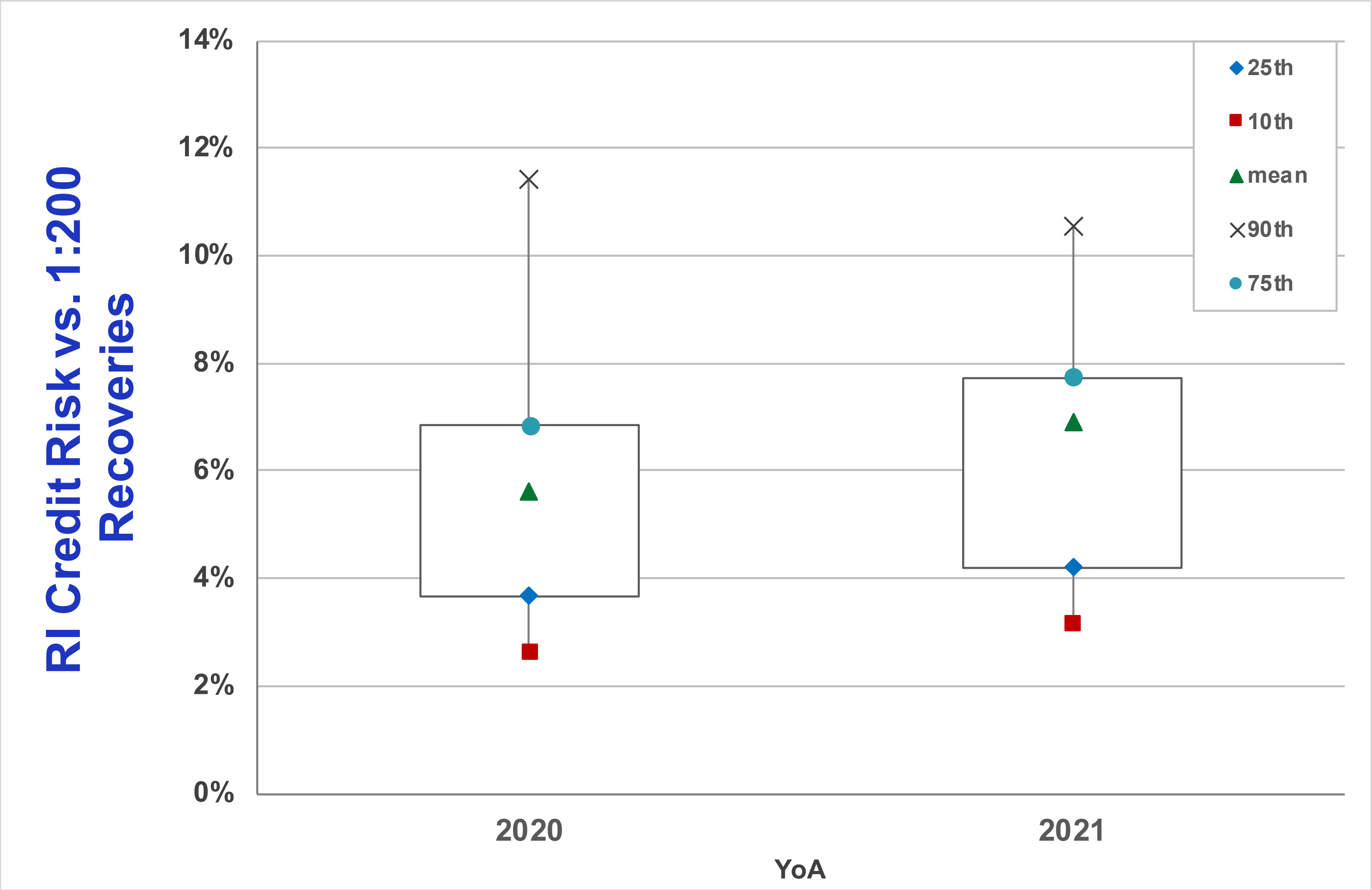
Market Risk vs. Available Assets



Ult Market risk (pre diversification): F309

Available Assets: F312 col Q Total less Proposed YOA + F313 table 1 col D row 1

RI Credit Risk vs. 1:200 recoveries



RI Credit risk (pre diversification): F309

1:200 Recoveries (approximated): F311 table 1 col G row 4 less row 3

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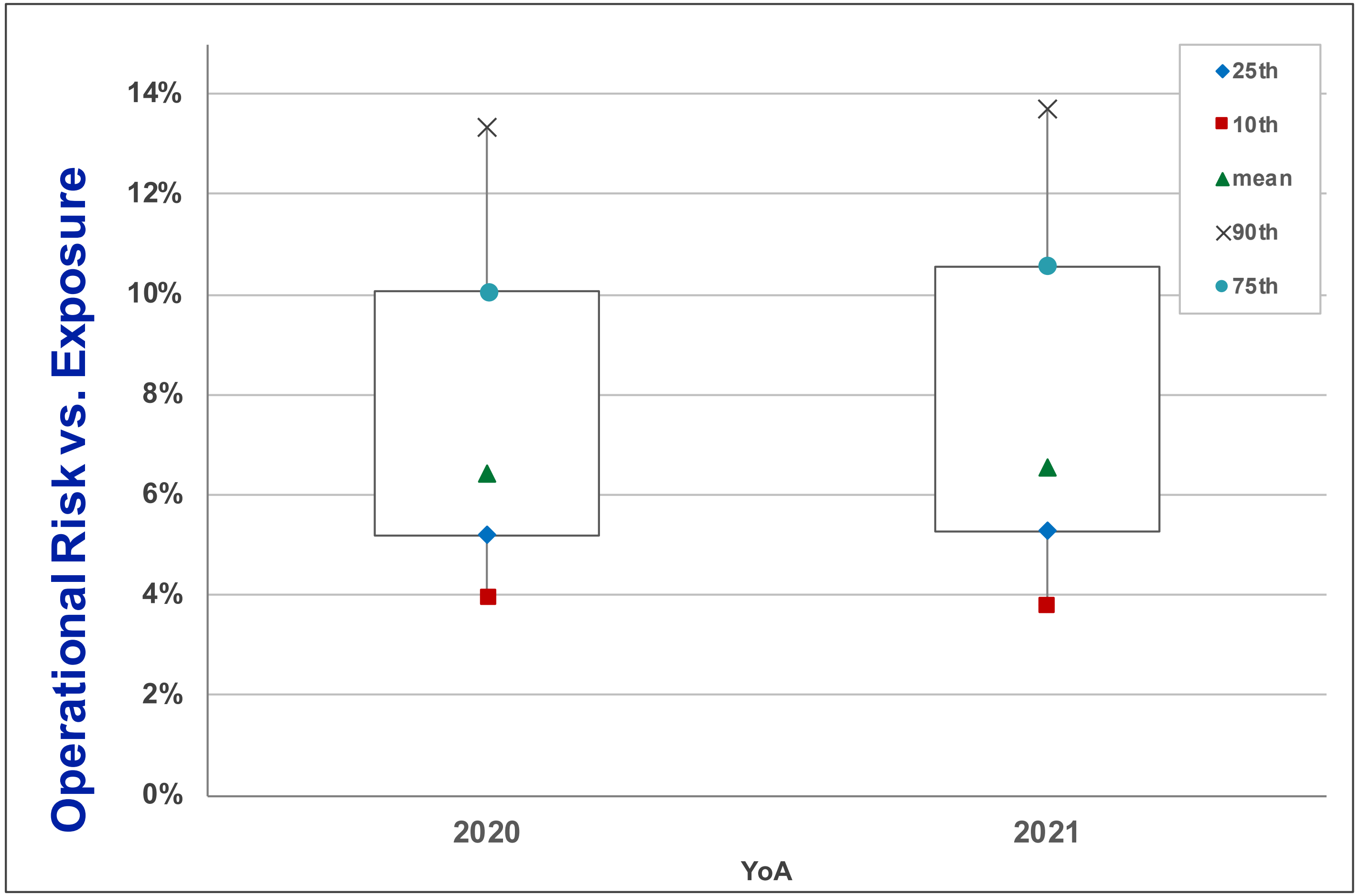
Operational risk vs. Exposure



Operational risk (pre diversification): F309

Exposure: (LCR 313.3 H1 + LCR 313.3 H4) + (0.5 * LCR 313.3 H5)

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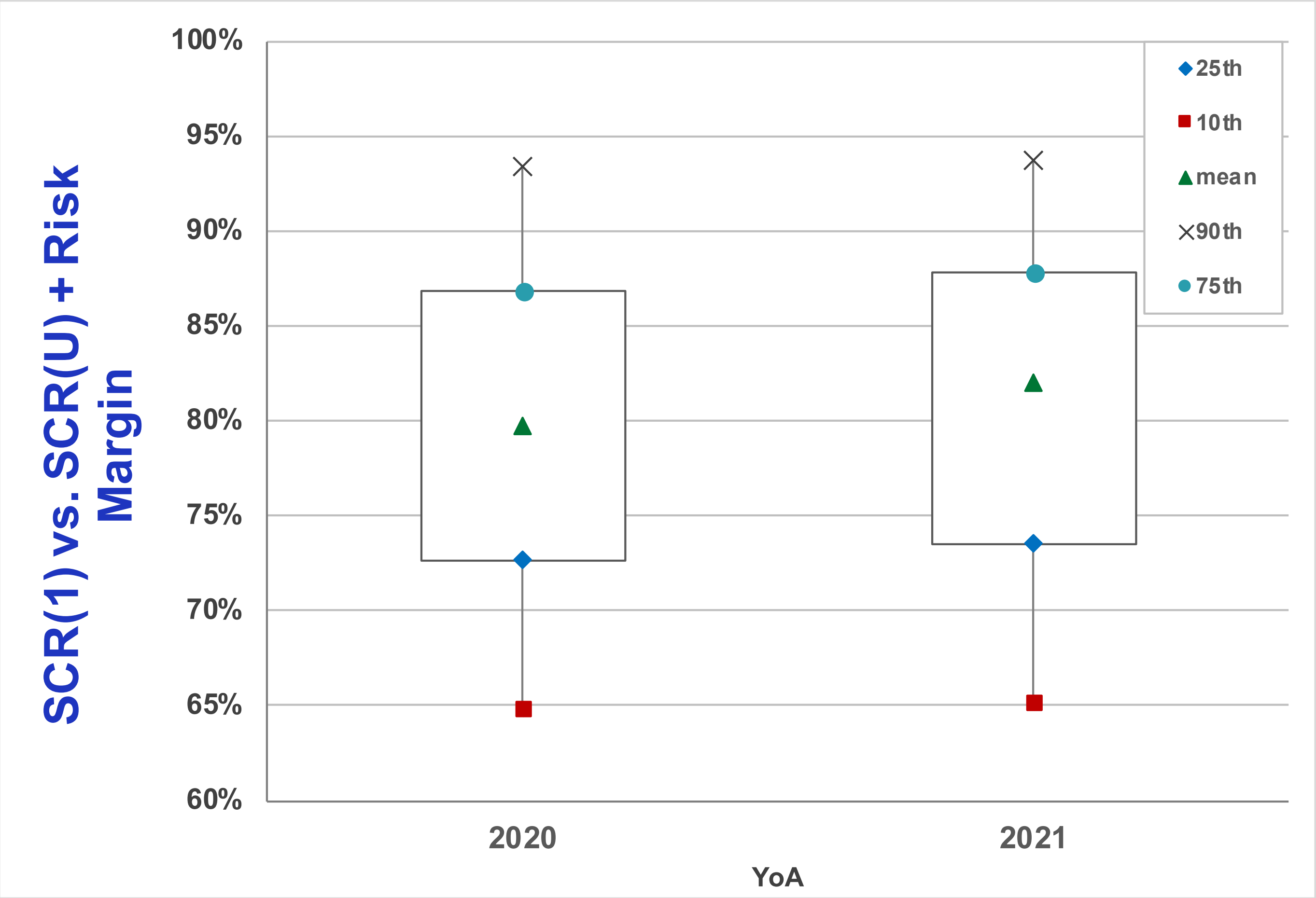
SCR(1) vs. SCR(U) + RiM

Excludes loads and other adjustments

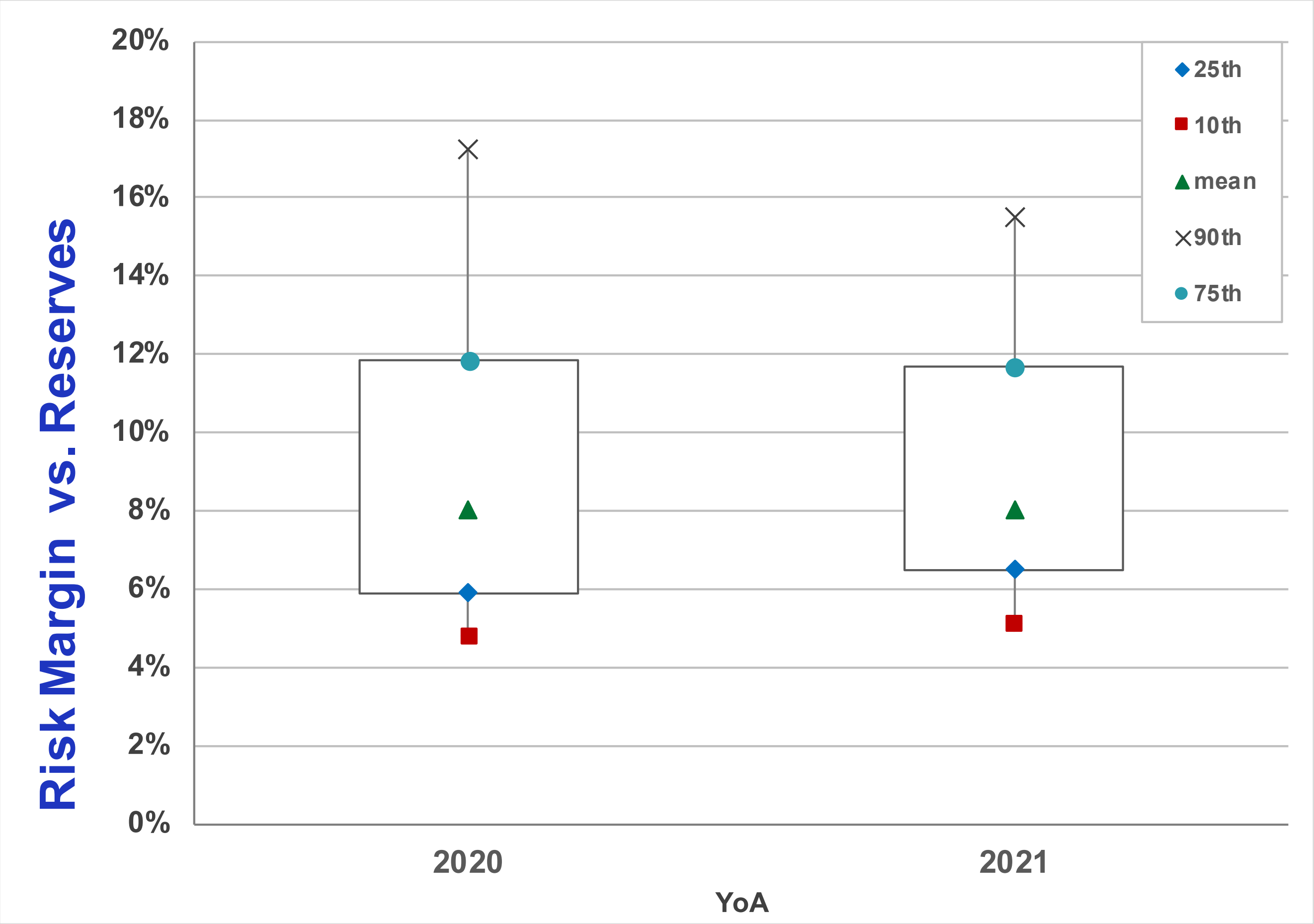


Ult SCR: F309
1YR SCR: F309
Both includes management adjustments

Risk margin: F312 col P total

Risk Margin vs. Reserves

Excludes loads and other adjustments

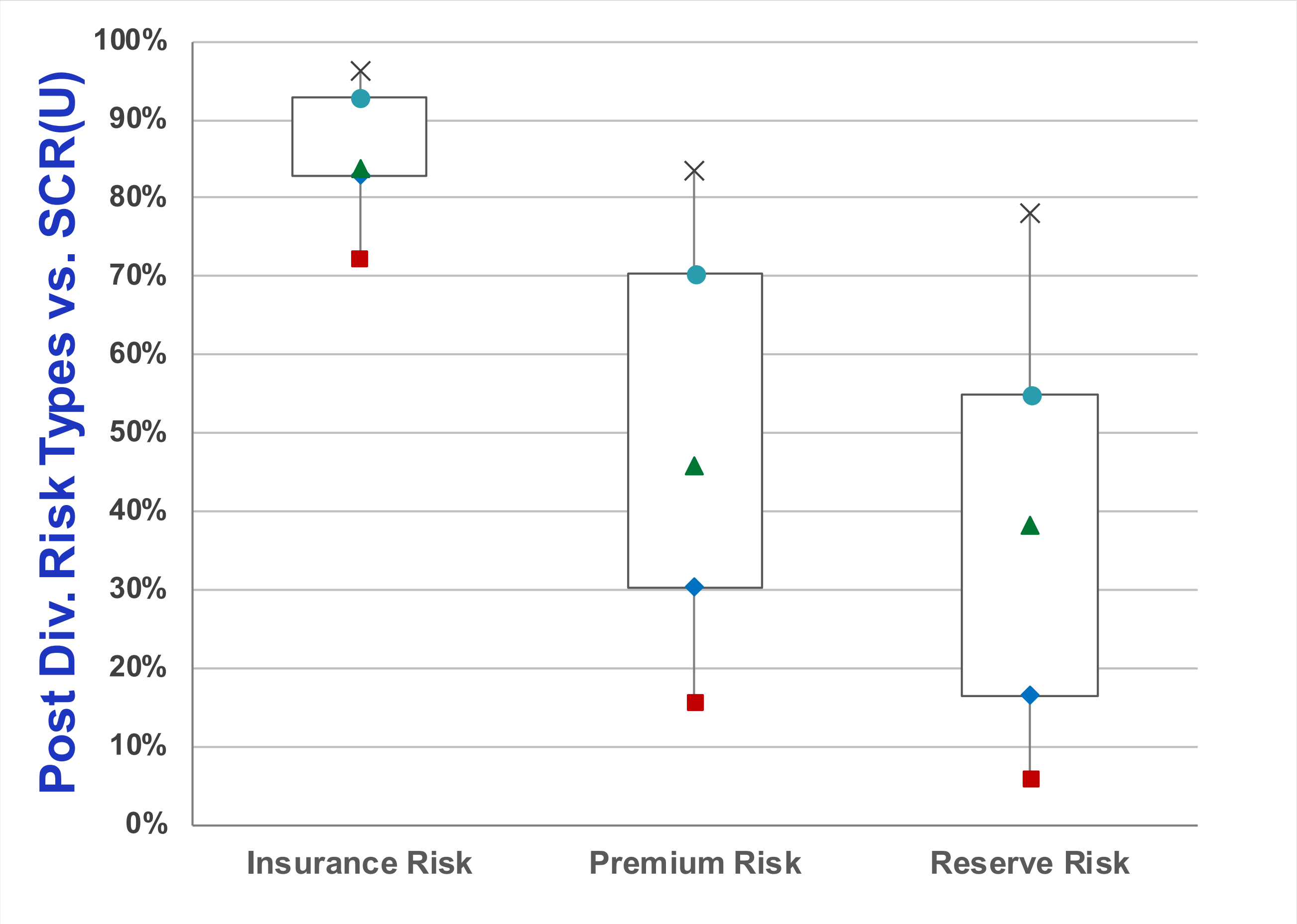


Risk margin: F312 col P total

Net Reserves: F312 cols H+I+J Total less Proposed YoA

Post Diversified Risk Types vs SCR(U) part 1

Excludes loads and other adjustments

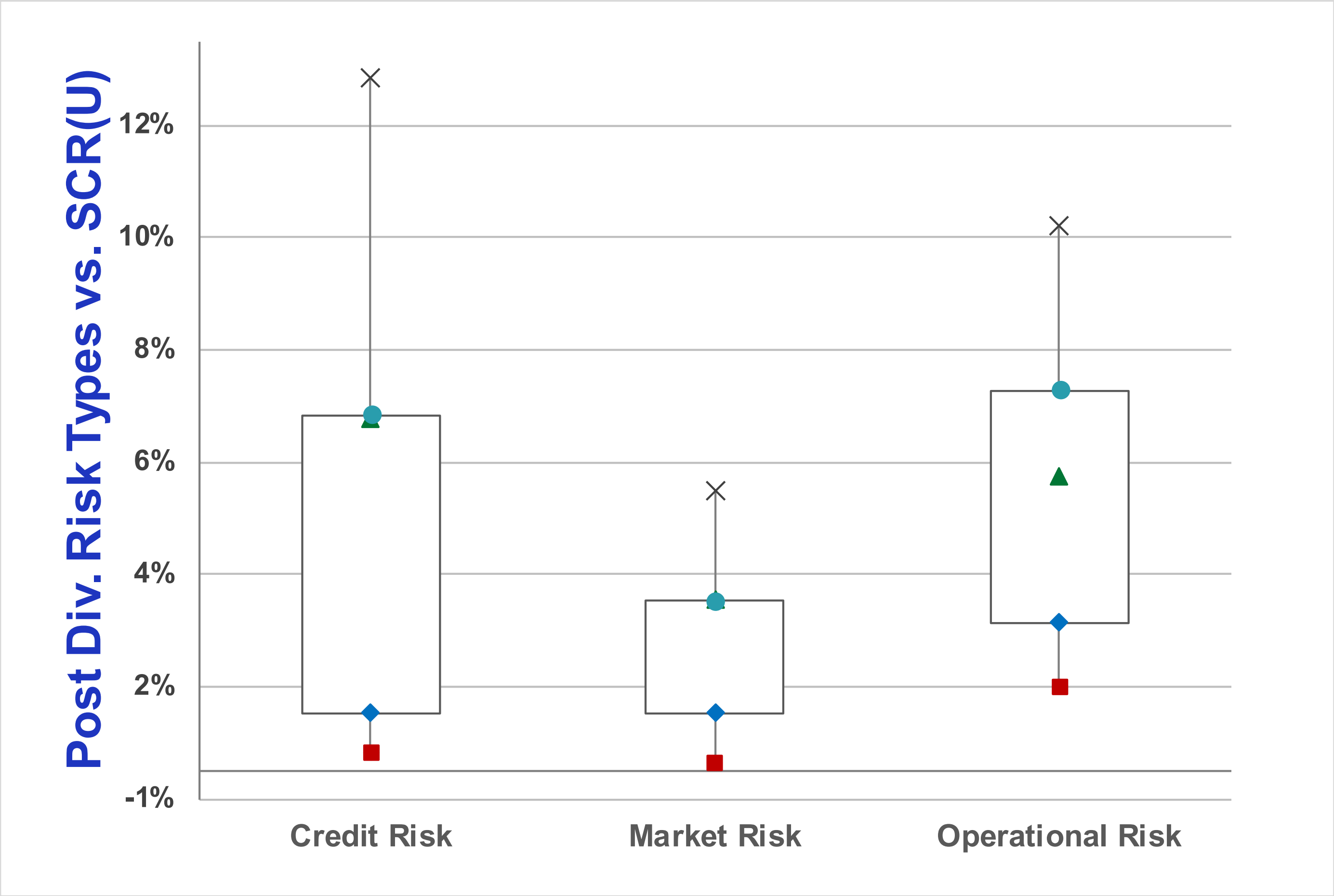


Post Div. Insurance Risk & Ult SCR: F309

Post Div. Premium & Reserve Risk: F541

Post Diversified Risk Types vs SCR(U) part 2

Excludes loads and other adjustments



Post Div. Credit, Market & Operational Risk & Ult SCR: F309