LLOYD'S

SOLVENCY II OWN RISK AND SOLVENCY ASSESSMENT (ORSA)

GUIDANCE NOTES

SEPTEMBER 2011

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INTRODUCTION

Purpose of this document

Lloyd's requires all managing agents to submit an Own Risk & Solvency Assessment (ORSA) as part of their application for internal model authorisation under Solvency II. An ORSA is required to be submitted to Lloyd's for all syndicates by 16 December 2011.

This document provides guidance for managing agents to support the development of the ORSA and, in particular, to assist with preparation for the December submission, building on the guidance issued in September 2010. Whilst this document contains guidance on the possible content and structure of syndicate ORSAs, it is provided for illustrative purposes and does not give detailed descriptions of specific aspects of the ORSA. It is important that syndicate ORSAs are designed and operated in a way that aligns with the structure and strategy of each managing agent – it is for businesses to create their 'own' process – and also many aspects of the ORSA will already exist as part of the current risk management processes at agents. As such, where specific example approaches are included within this guidance, these are intended to be used for reference and not as prescriptive templates which agents should follow.

This document contains three sections and a supporting appendix:

- **Introduction**: Context and background on the ORSA
- **Syndicate ORSA guidance**: Summary of Lloyd's expectations for syndicate ORSA submissions. In particular, this section outlines requirements for the first syndicate ORSA submission in December
- **Lloyd's use and oversight**: Summary of how Lloyd's intends to use and review syndicate ORSA submissions on a 'business as usual' basis
- **Appendix**: Illustrative ORSA Report structure

Agents should note that this document provides practical guidance on the ORSA and does not seek to set out detailed guidance on Solvency II requirements. Lloyd's "Detailed Guidance Notes for Dry Run Process" issued in March 2010 continues to be valid and agents should continue to refer to this for specific requirements on the ORSA (Article 45) and, where relevant, the Use Test (Article 120).

Agents should also note that this document has not yet been subject to a full and detailed review by the FSA. This guidance and any further material issued is subject to ongoing discussion and change as the European Commission (EC), European Insurance and Occupational Pensions Authority (EIOPA) and FSA requirements evolve over time.

Lloyd's ORSA framework

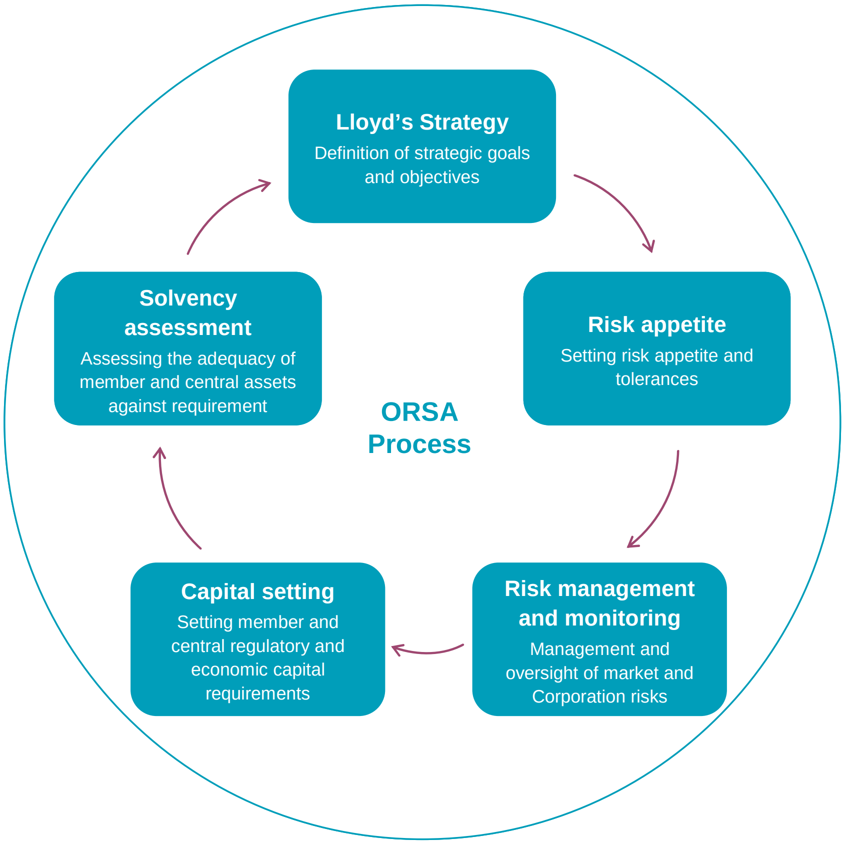
The Framework Directive, in Article 45, defines the need for all insurers to conduct an own risk and solvency assessment (ORSA), including an evaluation of "the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy".

Lloyd's interpretation of the ORSA is that it requires management to consider their own assessment of risks and associated economic capital needs, which differs from the regulatory capital requirement providing a minimum capital threshold. Assessment of economic capital is likely to consider a number of factors including:

- Strategic objectives
- Current and future risk profile, and
- Capital buffer desired by management

To achieve this overall aim, the Lloyd's Society ORSA incorporates several key processes used to manage risk and capital, many of which have been in place for some time, which act as a 'wrapper', ensuring activities link together effectively. The Lloyd's Society ORSA framework is summarised in below.

Lloyd's Society ORSA Framework



When considering the ORSA, it is useful to distinguish between the ORSA process and the ORSA report:

ORSA Process

The ORSA can be defined as "the entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short and long term risks a (re)insurance undertaking faces or may face and to determine the own funds necessary to ensure that the undertaking's overall solvency needs are met at all times"[1].

The ORSA process is likely to build largely on existing activities used by managing agents to effectively manage risk and capital. As such we would not expect the ORSA to require significant development over and above the aspects of a robust risk management framework that has been enhanced to meet Solvency II requirements. Rather, the ORSA should be the mechanism through which various aspects of the risk management framework interact to determine management's own view of risk exposure and associated economic capital needs.

ORSA Report

The ORSA process should operate continuously through the course of the year but must be accompanied with periodic formal reporting. It is reasonable that the formal ORSA report builds on the information viewed by

[1] EIOPA: ORSA Issues Paper, 27 May 2008 (https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/IssuesPaperORSA.pdf)

management through the year in order to make strategic risk and capital decisions, supplemented with specific additional items. Within the Lloyd's Society framework, a 'full' ORSA report will be produced annually (and additionally at intermediate times if capital adequacy is impacted either through capital erosion from a material event or a material change in the risk profile) with management monitoring critical metrics from the ORSA on a quarterly basis through regular risk and capital MI reporting. The 'full' ORSA document acts as an 'end of year report' which allows management to observe the collective implications of the various decisions made through the course of year and take a more strategic, forward-looking view of future risks and capital needs.

GUIDANCE FOR SYNDICATE ORSAs

Overview

This section describes Lloyd's expectations of syndicate ORSA submissions and may be read in conjunction with the appendix which sets out an illustrative structure of an ORSA report based on the content under development at Lloyd's.

As described in the previous section, the central aim of the ORSA is to provide agents with a mechanism through which management can assess the risks faced and determine the level of economic capital required to meet the strategic objectives of the business. Above all else, it is essential that the ORSA process is useful for management, allowing them to obtain a real and practical understanding of the risks to which each syndicate is exposed and the capital required to cover those risks. As such the ORSA should consider risk, capital, performance and strategy processes, and should provide management with information required to make key decisions regarding the overall risk and capital profile of the business.

Whilst the intention is not to prescribe a specific ORSA framework that should be adopted, there are a number of key outcomes of the ORSA which Lloyd's would normally expect to observe within agents' processes. The table below summarises these outcomes, providing a brief description of elements agents could consider in the design of their individual ORSA processes and reports. The table is updated from that provided in previous guidance to reflect latest thinking following further development of the Lloyd's Society ORSA, completion of a pilot ORSA report and consultation with the LMA. Lloyd's recognises that, depending on the precise nature and structure of each syndicate, the way in which each of these aspects is approached may differ considerably (for example according to the nature and sources of capital).

Area	ORSA outcomes	Description
Strategy and Risk Appetite	**Strategy**	• Business strategy and the impact on the risk profile of the syndicate, for example future business plans
Risk	**Current risk profile**	• Risk appetite statements/metrics and assessment of the current risk profile against defined appetite • Assessment of risks which may not be quantified within the SCR such as group, reputational and regulatory risks • Assessment of risks arising from any inadequacies in the system of governance • Assessment of the effectiveness of controls in place to mitigate against key risks
	Future risk profile	• Assessment of future risk profile given expected changes in external environment and business plan projections • Assessment of emerging risks
Capital and Solvency	**Regulatory capital**	• SCR as calculated using the internal model • Assessment of the appropriateness of the SCR given the risks faced (for example through evaluation of model assumptions, risk correlations, etc)

Area	ORSA outcomes	Description
Capital and Solvency	**Member capital**	• ECA for the purposes of determining (one-year) member's FAL • NB: ECA will continue to be set by Lloyd's on a consistent basis, outside of the syndicate ORSA review process (see "Lloyd's oversight and use" section below)
	Economic capital	• Agent's own assessment of economic capital needs based on the actual and potential risks faced both this year and over the strategic planning horizon
	Solvency	• Assessment of available funds against capital requirements, both now and based on future projections; Assessment of capital planning and adequacy • NB: Lloyd's recognises the nature and make up of 'available funds' will differ considerably according to the structure of individual syndicates (for example agents may have limited transparency over available capital where this is provided by third party capital). Therefore we may expect agents to reference this within the ORSA report and note potential actions/contingency plans where available capital is likely to be insufficient to support future business plans. We would not, however, expect this to change the role of agents with respect to assessing solvency • Furthermore, Lloyd's would expect agents to plan capital and solvency on the basis of the continued operation of Lloyd's, including the Chain of Security and Society rating. The Lloyd's ORSA process will be used to ensure continued financial strength of Lloyd's across the Chain of Security and information will be publicly available regarding the financial position of Lloyd's (e.g. size of the central fund, solvency deficit) for agents. We would not expect agents to routinely allow for changes to this structure as part of their own ORSAs.
	Capital contingency plans	• Description of capital contingency plans where future funds may be insufficient to meet capital needs • This may include assessment of contingent capital or access to additional funds (e.g. from parent) post-event
Stress-testing	**Stress and scenario tests**	• Risk, capital and solvency position under stressed conditions
	Reverse Stress Test (RST)	• Results and conclusions of reverse stress tests
Embedding	**Board approval**	• Confirmation of Board approval of the ORSA
	Use	• Evidence of how the internal model is used within the ORSA • Evidence of the involvement of senior management within the ORSA process

December ORSA submission

As described in the Dry Run Review Process Guidance Notes (issued in February 2011), agents will be required to submit an initial ORSA no later than 16 December 2011. The objective of this submission is to ensure agents have a clear understanding of the ORSA and how this will be applied within their businesses. As such, we would expect the constituent elements of the ORSA to be sufficiently developed (if not final and fully embedded) to support meaningful Board and senior management discussion on the risk, capital and solvency profile of each syndicate. Furthermore, the December submission is intended to provide comfort to Lloyd's that agents are well advanced in their development of the ORSA in order to support the overall Lloyd's FSA application in 2012.

Documentation and evidence

For the December submission, we would expect agents to submit:

- **ORSA report:** Latest version of the ORSA report, providing the latest output from the ORSA process. We would not expect at this stage the report to be a finalised document, though agents should be able to demonstrate strong progress towards a final report and for the report to be comprehensive (i.e. all aspects of the ORSA should be included). Appendix 1 provides an illustrative outline of the ORSA report which may be used by agents as a check against their current structure.
- **ORSA policy / framework**: The current Level 3 "pre-consultation" proposals provide draft guidance on the expected documentation surrounding the ORSA, including the 'ORSA Policy'. We would expect the ORSA Policy to describe the overall ORSA process, how this is integrated with the strategic and business planning processes of the agent and the role of the Board and management in the running of the ORSA. This submission may comprise a number of individual documents (including documents referencing other aspects of the risk management framework). It will be critical to demonstrate how these aspects work together in order to meet the objectives of the ORSA.

At the point of submission, agents will need to be able to evidence that the Board has been involved in the development of the ORSA and have discussed the results of the process: however, we would not require the ORSA to be finalised or fully approved by the Board at this stage, or to have been independently reviewed.

Guidance on specific issues

- **Multiple syndicates / Groups**: Lloyd's will expect agents to produce a separate ORSA report for each syndicate. However, where an agent manages more than one syndicate or forms part of a wider group company and there is common information, for example the risk strategy, Lloyd's would expect this information to be merely referenced rather than repeated in each document. Alternatively, the ORSA report may cover the business as a whole with syndicate-specific information contained, where relevant, in individual appendices.
- **Reporting basis**: The ORSA should be run using the information basis which is understood by management and used to run the business. Where this may be different to the Lloyd's basis (for example for forward-looking projections), it is acceptable to use this basis within the ORSA report submitted to Lloyd's. Lloyd's would ask agents to clearly explain where different reporting is used and reconcile figures that differ materially to other submissions to Lloyd's (for example business forecasts).
- **Timing**: Lloyd's recognises that agents may develop ORSA Reports at different points during the year according to individual business cycles. As such, we would ask agents to clearly state the 'as at' date for the ORSA report but do not intend to prescribe when ORSA reports are generated through the year – this must be determined by the Board of each agent. Lloyd's may request to see the latest ORSA documentation from an agent at any point through the year but does not intend to request full documentation on an annual basis. As noted above, the ORSA Process will operate continuously throughout the year; the Report is a formalisation of output from this process
- **Time horizon**: A key aspect of the ORSA is consideration of capital requirements over a longer time-horizon than the one-year business forecast. Whilst it is important for agents to consider the most appropriate time-horizon for their businesses, Lloyd's is considering scenarios up to a three-year horizon for the purposes of the Society ORSA to align with the rolling three-year strategic plan. We would expect syndicate forecasts similarly to include at least three years of new business (planned year plus two years of

forecast). We would expect some information to be currently available to inform this forecast within going concern assumptions required in the preparation of audited accounts.

LLOYD'S USE AND OVERSIGHT

This section outlines at a high level how syndicate ORSAs will link to the overall Lloyd's risk framework on a business as usual basis. The detail of this activity remains under development hence the information provides the principles of the proposed approach only. It should also be noted that this section is currently under consideration by the FSA and is still subject to approval.

In principle, syndicate ORSAs are likely to be used by Lloyd's in two key ways:

- Demonstrate overall Solvency II compliance
- Input into Lloyd's Society ORSA

Demonstrate overall Solvency II compliance

Lloyd's must be able to demonstrate that agents meet the requirements of Solvency II on an ongoing basis. To achieve this, Lloyd's intends to develop a process to review syndicate ORSAs. This review would focus on the adequacy of the risk management and governance processes used by the agent rather than the outcomes and implications of the ORSA since these are a tool for syndicate management. For example, Lloyd's may comment on the quality of a managing agent's ORSA (both in terms of the quantitative and qualitative aspects) and would seek to understand the process by which decisions are made within the ORSA framework.

The review is likely to be performed using a risk-based approach, leveraging existing knowledge of the agent to avoid duplication of submissions. Lloyd's may use the ORSA to guide the business as usual review work performed during the course of the year, for example if the risk appetite approach outlined within the ORSA is considered inadequate, this may trigger a more detailed review on the topic. Similarly, routine work carried out during the year to review risk management approaches at agents will educate the ORSA review and contribute to it.

To meet Solvency II requirements, agents will be required to perform an ORSA at least annually and to confirm to Lloyd's the 'as at' date of the most recent ORSA.

Input into Lloyd's Society ORSA

Syndicate ORSAs will link to the Lloyd's Society ORSA in two key ways:

- Identification and validation of key risks and issues: Syndicate ORSAs will provide useful information on agents' views of key risks across the market. The Lloyd's Society ORSA will use this information to identify key themes and validate the information gathered from existing market oversight processes
- Aggregation of forward-looking projections: Each syndicate will provide a view of how risk exposure and profile is expected to change over time. The Lloyd's Society ORSA will use this information to inform an aggregated view of the future risk profile of the market to assess the adequacy of *central* Lloyd's capital (i.e. central assets as opposed to member assets) over the longer term. We would expect syndicate ORSAs to be developed in different ways as required to meet the needs of individual businesses hence this aggregation will be performed in a qualitative way. Additionally, salient information on the forward-looking projections of individual syndicates may be provided as an input into the Lloyd's business plan approval process where it may have implications for approval of the one-year business plan. As noted above, use of syndicate ORSA output within the Lloyd's Society ORSA remains under development.

It is also worth noting that, whilst syndicate ORSAs will be used as described above, the intention is that syndicate ORSAs will not provide a direct, mathematical link into the Lloyd's Internal Model or the Lloyd's Society ORSA. Some aspects of syndicate ORSAs and economic capital calculations may be used indirectly in the development of LIM (for example validation), however quantitative information on syndicate plans and performance used as LIM inputs will continue to be sourced from existing market oversight processes. This allows syndicate management to develop bespoke ORSA processes and reports tailored to meet the characteristics of individual businesses. As noted above, it is for this reason that Lloyd's does not propose to prescribe the format or content of the ORSA report (for example in the way ICA submissions are currently prescribed).

Similarly, the intention is that syndicate ORSAs will not be used to set member capital requirements and the process used to calculate ECA will be consistent with the current regime. As such, agreement of member capital will remain a separate process to the ORSA and will use a Lloyd's calculation basis in order to:

- Ensure consistency, equity and transparency across the market
- Differentiate between capital required for the one-year venture (member's FAL) and the more strategic, forward-looking perspective (syndicate ORSAs)
- Differentiate between minimum capital required to write at Lloyd's (member's FAL) and target capital level (syndicate ORSAs)

Similarly, the process and timing to recapitalise (coming into line) will remain consistent with the current regime and syndicate ORSAs should be planned on this assumption.

APPENDIX: ILLUSTRATIVE ORSA REPORT TEMPLATE

The illustrative ORSA Report template shown below is based on the report structure used for the Lloyd's Society ORSA Report. It is based on the example ORSA report template issued in September 2010 but reflects addition development work subsequently undertaken by Lloyd's. However, Lloyd's considers the September 2010 template to still be valid and agents may use this format if they choose.

ORSA Report structure [in development]

Section	Summary description	Est. pages
A. Executive Summary	• Summary of the ORSA results for discussion	3-5
B. ORSA process	• Summary of the ORSA process • Highlights any key aspects from the most recent results	1-2
C. Strategy and business context	• Summary of current business strategy and risk appetite • Demonstrates link between strategy, risk and capital	1-2
D. Risk exposure	• Current risk profile against risk appetite • Includes market and Corporation risks	3-5
E. Capital requirement	• Required capital (regulatory and economic) • Analysis of key drivers	3-5
F. Solvency assessment	• Available funds to meet capital requirement • Analysis of composition	1-2
G. Forward-looking assessment	• Expected future risk, capital and solvency profile • Capital plan and contingency planning as required	1-2
H. Stress & scenario testing	• Potential risk, capital and solvency profile under various stressed conditions	1-2
I. Independent Assessment	• Summary outcome of independent review of ORSA	1
J. Appendices and References	• Additional information as required, in particular documentation of 'static' elements of the ORSA	TBC
Total		**15-25**

The Lloyd's ORSA Report will be developed in a modular format to satisfy a number of internal and external stakeholders (e.g. Board, Executive Team, FSA, rating agencies, public disclosure). The Report will be used to highlight key issues to management and facilitate discussion.

It is intended that a 'full' ORSA Report will be produced annually with key metrics monitored on (at least) a quarterly basis. The 'full' document will include both documentation of the ORSA processes (expected to remain relatively static over time) and detailed output (expected to evolve from report to report).

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