

# GOVERNANCE, RISK MANAGEMENT & USE WORKSHOP

17 & 18 May 2011

# Agenda

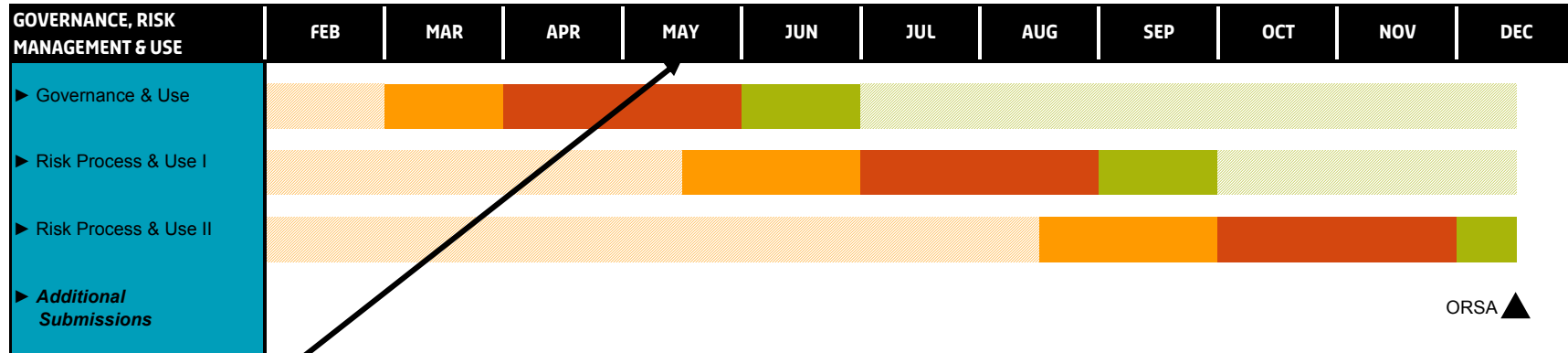
- Introduction
- Feedback from initial reviews
- Lloyd's approach to the 'Use' test
- Syndicate 999 - Risk appetite

*Table discussions and play back/Q&A*

- Next steps

# **INTRODUCTION**

# Progress to date on workstream



**You are here**

<u>Governance &amp; Use</u>	<u>Risk Process &amp; Use I</u>	<u>Risk Process &amp; Use II</u>
<ul style="list-style-type: none"> <li>• Fit &amp; Proper</li> <li>• Internal Control</li> <li>• Outsourcing</li> <li>• Governance &amp; Board operations</li> <li>• Risk Governance (including model governance)</li> </ul>	<ul style="list-style-type: none"> <li>• Internal Audit</li> <li>• Risk Appetite</li> <li>• Model Change Policy</li> <li>• Model Scope/Coverage</li> </ul>	<ul style="list-style-type: none"> <li>• Identification, assessment, control &amp; mitigation</li> <li>• Monitoring &amp; reporting</li> <li>• Actuarial function</li> <li>• Use test wrap up</li> </ul>
<p><b>ORSA &amp; Use test</b></p>		

# Today the focus is on Governance, Risk Management & Use workstream ...

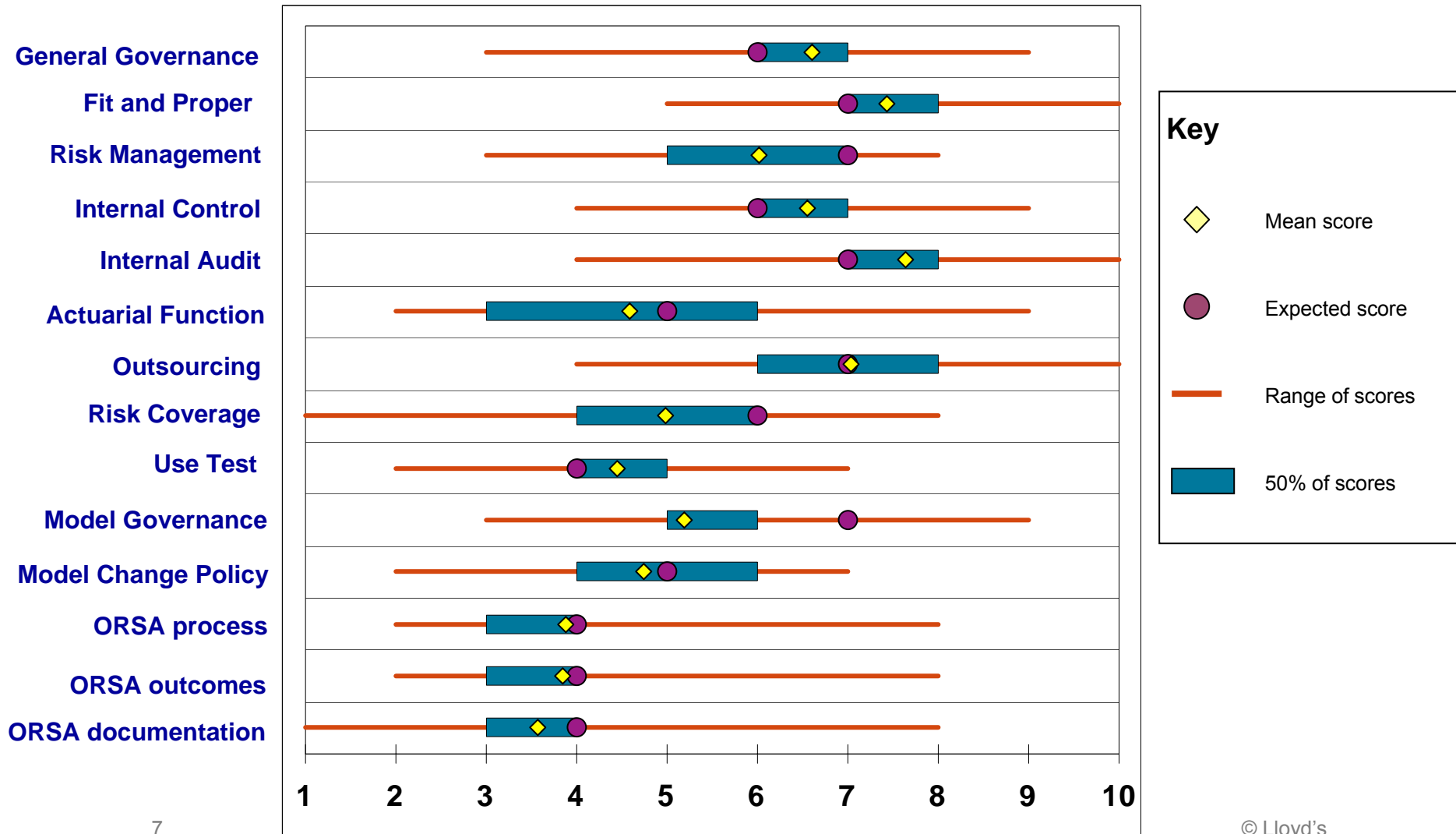
- First workshops held 1 & 3 March
- Evidence template issued 28 February and scoring expectations re-issued 31 March
  - scoring updates submitted by agents early March (as at Q4 2010) and 6 May (as at Q1 2011)
  - first iteration of evidence templates submitted by agents 31 March
- Lloyd's reviews of outsourcing and internal control completed and feedback ongoing
- Governance & board ops and risk governance reviews commenced
  - initial documentation request
  - offer of walkthrough sessions

## ... but strong links with other workstreams

- Internal Model SCR
  - model scope and model governance
  - calculation of operational risk
- Technical Provisions
  - actuarial function
- Model validation
  - scope of validation covers governance and use test
- Documentation and final application
  - Board understanding and sign off on “application”

# Latest self assessment scores

## Agent self assessment – Q1 2011



# **FEEDBACK FROM INITIAL REVIEWS**



# Outsourcing – Review findings

- Explicit definition of Outsourcing, a definition provided by the FSA is:  
*"an arrangement of any form between a firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the firm itself."*
- Group arrangements:
  - Written agreements must be in place.
  - Ability to choose service provider.
- Further definition could also be included within the policy statement on:
  - Due diligence assessment process.
  - Performance reporting.
  - Sufficient in house competence.
  - Auditing outsource activities.

## **Our expectation is that ELOPA will resolve that delegated underwriting will constitute outsourcing**

- Important to use existing documentation on these arrangements.
- Reference in outsourcing policy to existing documentation.
- However, it may prove necessary for those procedures and policies for delegated underwriting to be amended in light of Solvency II requirements.
- Certain market wordings may also need amendment.

# Internal Control – Policy – Review findings

- Is one required?
- Quality of policies varied a lot.
- A good Internal Control Policy:
  - Holistic view
  - Ensures coverage of controls
  - Demonstrates how control is embedded
  - Ongoing reporting
  - Reduces key person risk
  - Details roles and responsibilities

# Internal Control – Compliance Plan

- Quality of plans varied a lot.
- Good plans included 3 key elements:
  - A schedule and explanation of Business as Usual Testing activity
  - A schedule and explanation of Business as Usual Monitoring activity
  - Project Activity
- Compliance Authority generally could be better defined.

## Other frequently asked questions

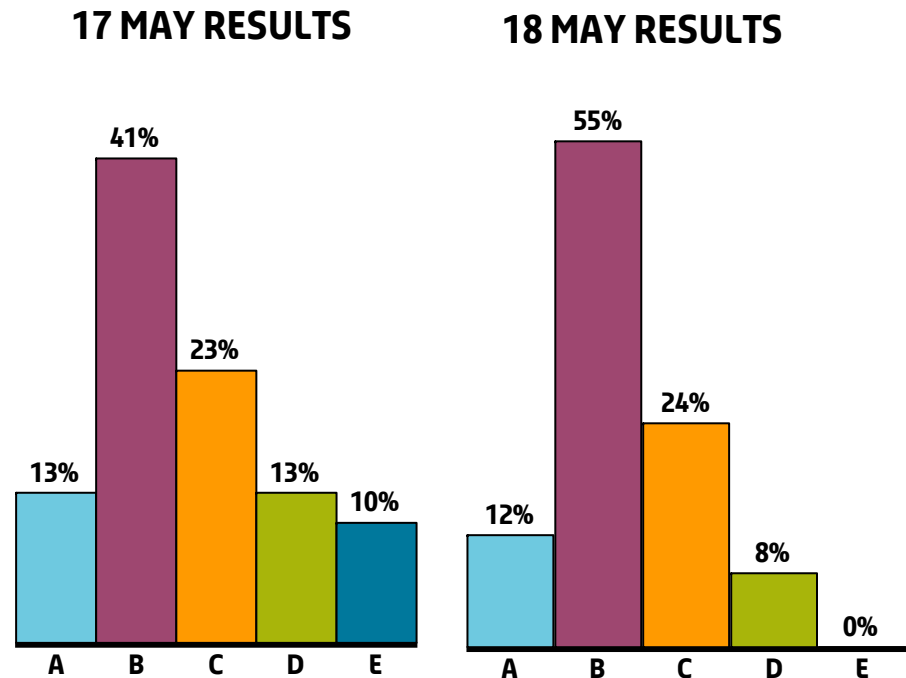
- How much work needs to be done beyond business continuity planning on risk mitigation/contingency plans?
- Are significant changes expected to the fit and proper checks undertaken to meet the needs of Solvency II?
- To what extent do we expect formal responses to our report recommendations?
- Will the ratings in the reports change once recommendations have been addressed?
- How is our FSA interaction going to work in this workstream?

# What next?

- Documentation requests and/or workshop type meetings have been set up for the following review programmes:
  - Governance and Board Operations
  - Risk Governance, including model governance
- Phase 2 of the review programme will look at the following key areas:
  - Internal Audit
  - Risk Appetite
  - Model Change Policy
  - Model scope and risk coverage
- Initial communications with regard to these reviews will take place in June.

# What work have you currently completed on ensuring delegated authorities and TPA's are appropriately covered by the Outsourcing framework?

- A. Fully completed
- B. Have separate documentation for delegated underwriting, but need to cross reference this within Outsourcing Policy.
- C. Referenced within draft version of Outsourcing Policy.
- D. Thought about how it may work but not documented anything yet.
- E. None



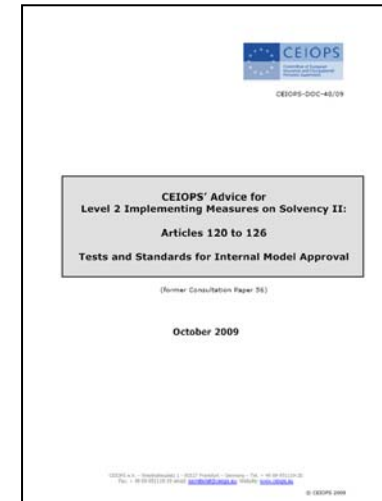
**LLOYD'S  
APPROACH TO THE  
'USE TEST'**



# Use Test

## Requirements

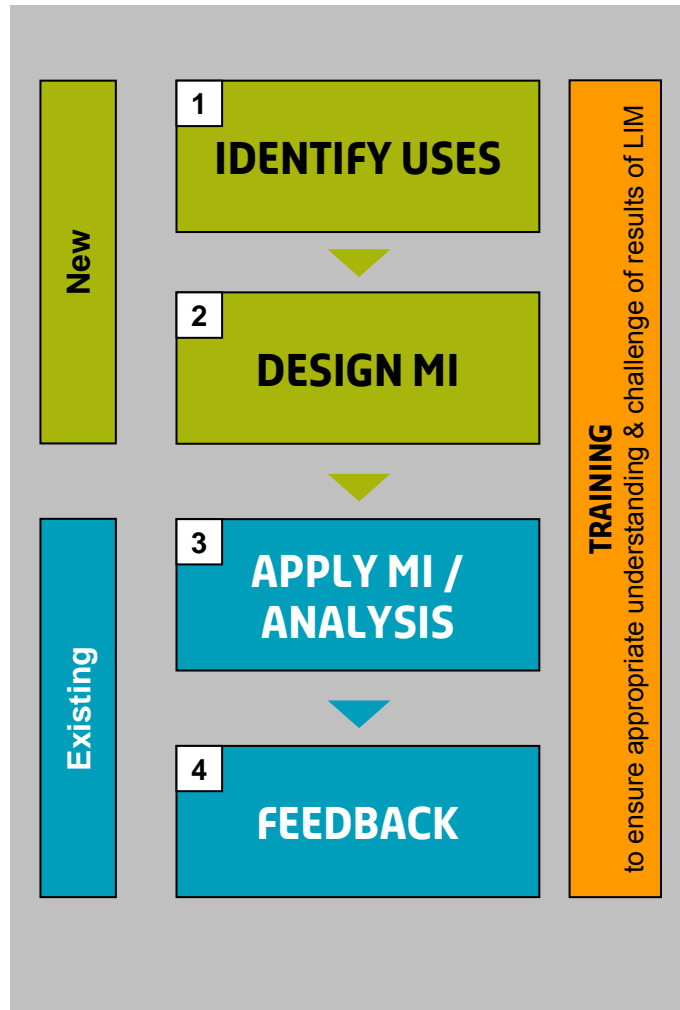
- Use test requires the Internal Model to be widely used in and play an important role in...
  - Risk management system
  - Decision making
  - Economic & solvency capital assessment & allocation processes
- EIOPA guidance provides a principle based approach: Foundation Principle & 9 other Principles



***...use of the internal model shall be sufficiently material to result in pressure to improve the quality of the internal model...***

# Use Test

## Lloyd's approach



- Key Aims:
  - Internal model is embedded in the business
  - Sufficient evidence to demonstrate use of the internal model (especially for application process)
  - Use of the internal model results in change / improvement

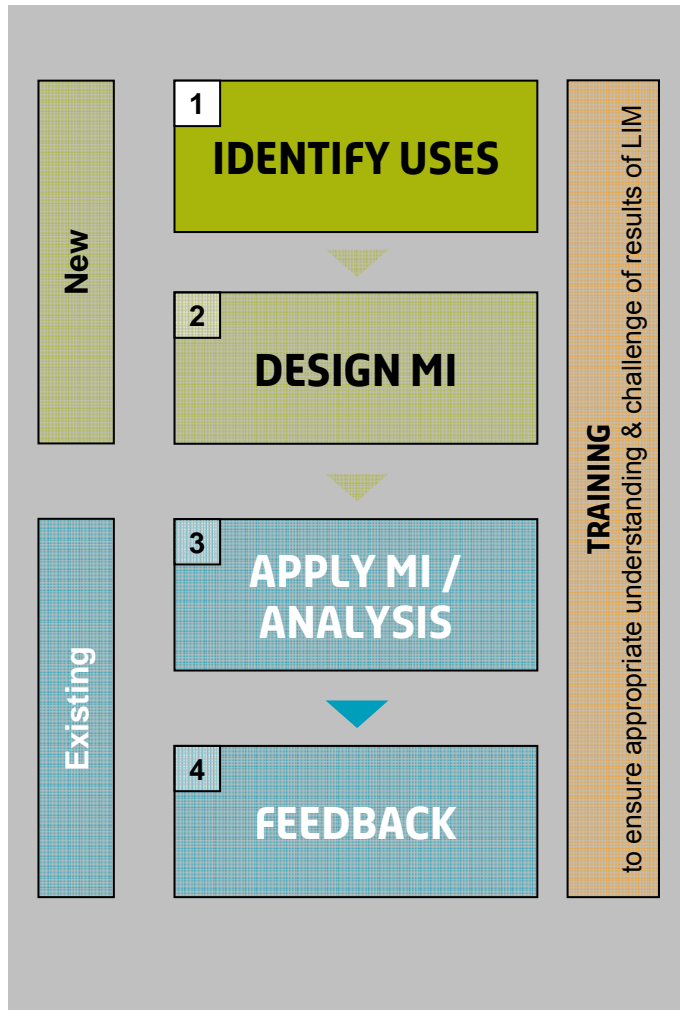
# Use Test

## Alignment to principles

CEIOPS PRINCIPLE		IDENTIFY USES	DESIGN MI	APPLY MI	FEEDBACK	TRAINING
<b>FOUNDATION PRINCIPLE</b>	The undertaking's use of the internal model shall be sufficiently material to result in pressure to improve the quality of the internal model.	✓	✓	✓	✓	✓
<b>P1</b>	Management shall be able to demonstrate understanding of the internal model			✓	✓	✓
<b>P2</b>	The internal model shall fit the business model	✓				✓
<b>P3</b>	The internal model shall be used to support and verify decision-making		✓	✓		✓
<b>P4</b>	The internal model shall cover sufficient risks to make it useful for risk management and decision-making	✓	✓			✓
<b>P5</b>	The design of the internal model shall facilitate analysis of business decision	✓	✓	✓		✓
<b>P6</b>	The internal model shall be widely integrated with the risk management system		✓	✓	✓	✓
<b>P7</b>	The internal model shall be used to improve the risk management system			✓	✓	✓
<b>P8</b>	The integration into the risk management system shall be on a consistent basis for all uses		✓		✓	✓
<b>P9</b>	The SCR shall be calculated at least annually. In addition, when there is a significant change to risk profile, assumptions or methodology, or where up-to-date information is required	✓				

# Use Test

## Identifying key uses



- Iterative process, considering:
  - Significant business processes/decisions
  - Significant risk inherent in the business
  - Risk committee reporting requirements
- Led by Risk Management with active business role
- Output:
  - Specification for the build of the model
  - Prioritised list of uses of the model
- Annual review of model uses

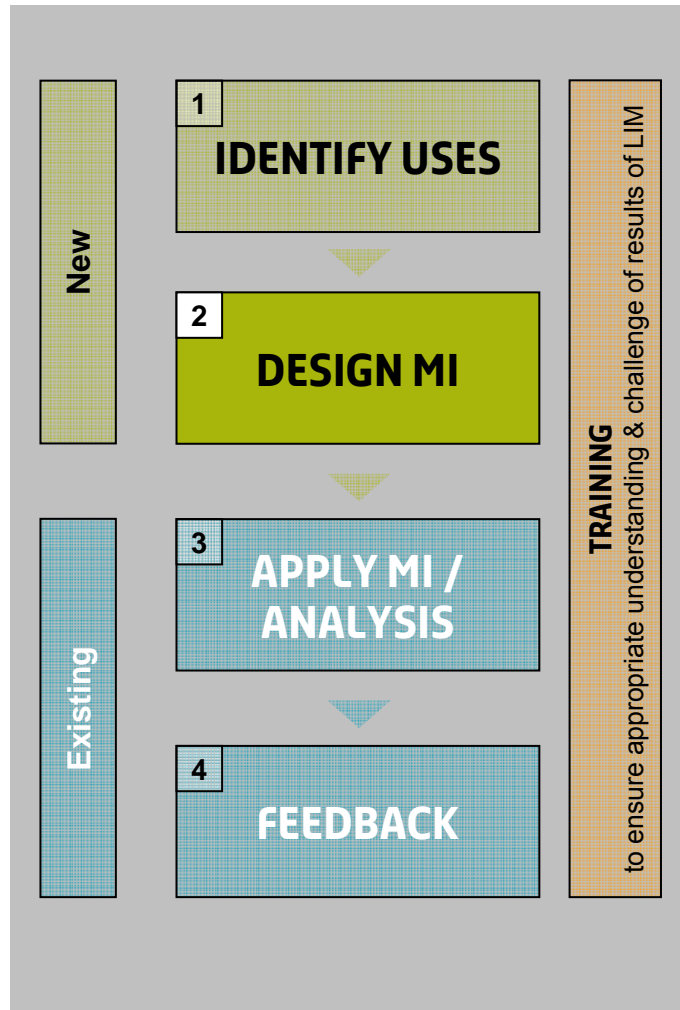
# Example 1

## Lloyd's uses

- A 'manageable' number of uses identified, debated and agreed upon, for example:
  - Monitor & manage investment risk for Central Fund assets
  - Monitor & manage catastrophe exposures
  - Benchmark syndicate SCRs
- A number are Corporation specific
- Extent to which each is embedded within the business a key focus:
  - Catastrophe Risk
  - Investment Risk

# Use Test

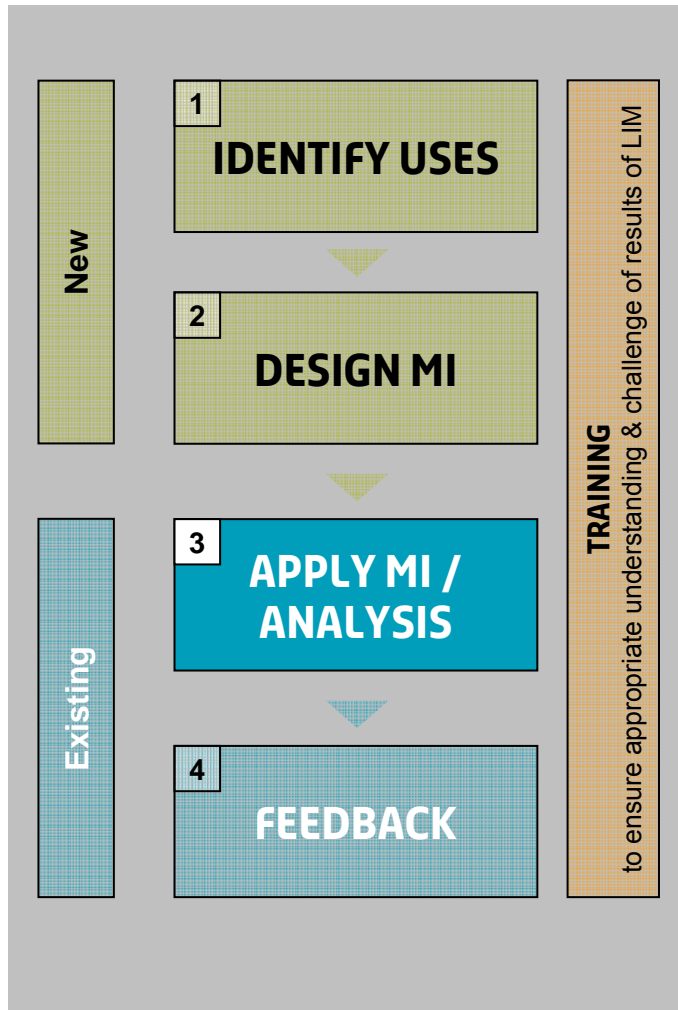
## Design & Develop MI



- MI development jointly driven by Risk Management and Model development team
- Outputs:
  - Development and production of appropriate MI for each use
  - Business area understanding of the outputs
  - Evidence supporting MI development process

# Use Test


## Applying MI



- Model and results must be regularly discussed at relevant committees and Board
- Evidence needs to demonstrate:
  - Use of model outputs as part of MI
  - Structured discussion and debate
  - Senior Management challenge
  - Use of MI to inform and improve understanding of risk profile and risk management system

# Example 2

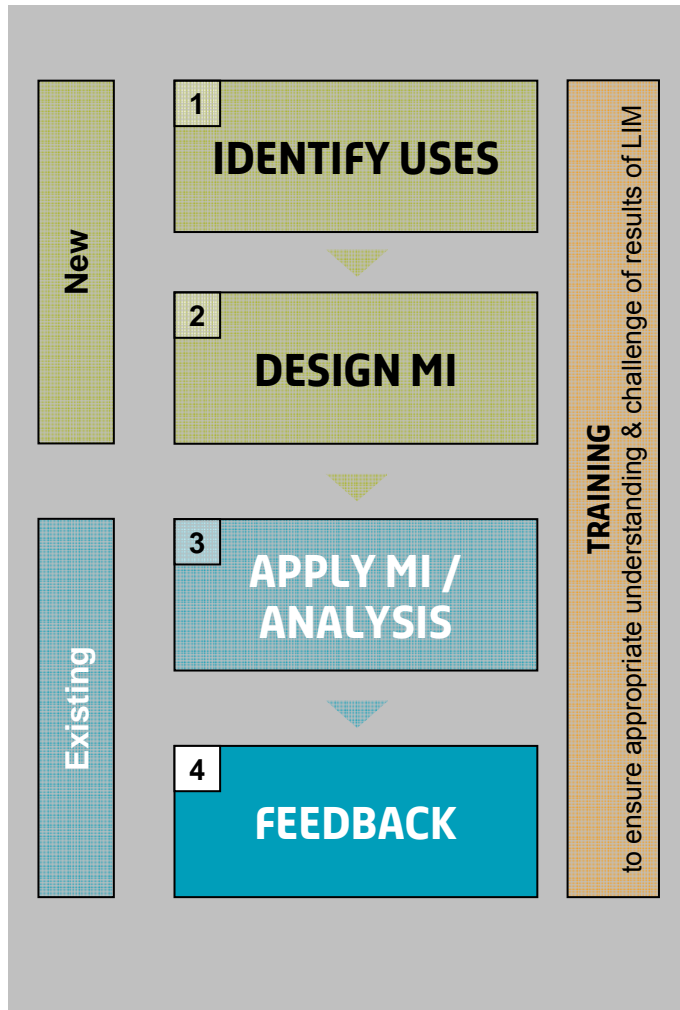
## Risk committee decision making

<p><b>IDENTIFY USES</b></p>	<p><b>Regulatory Guidance:</b> Article 121 .... “the ability of the internal model to rank risk shall be sufficient”</p> <p><b>Identified Use:</b> 21. Key risk identification and measurement</p>
<p><b>DESIGN MI</b></p>	<p>Review outputs from risk management system, incl:</p> <ul style="list-style-type: none"> <li>- Risk exposure, overall</li> <li>- Risk exposure, by risk type</li> </ul> 
<p><b>APPLY MI / ANALYSIS</b></p>	<p>Challenge, debate and ultimately decision using MI from the internal model Evidenced through meeting agendas, minutes and discussion / decision papers</p>
<p><b>FEEDBACK</b></p>	<p>Use and understanding of modelled data may provide insight into the risks and pressure to improve the internal model Weaknesses / improvements in internal model data feed back to modelling team</p>
<p><b>TRAINING</b></p>	<p>Objectives, Requirements &amp; Delivery of appropriate training material for Risk Committee</p>



# Use Test

## Feedback

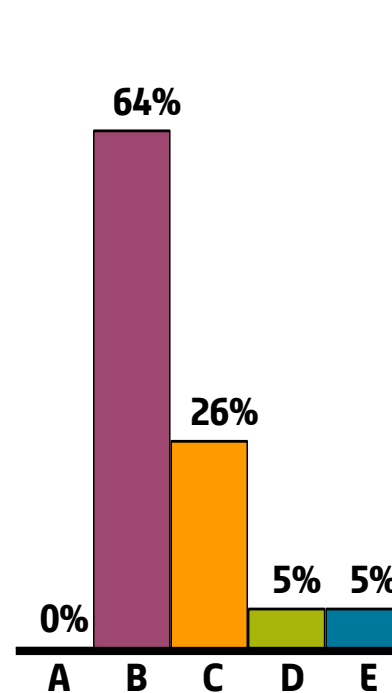


- Use of the internal model can create opportunities to improve the model itself
- Formalising the feedback loop ensures that potential improvements and changes are captured
- Feedback inputs to both the model and the risk management system
- Documentary evidence supports the process on an ongoing basis

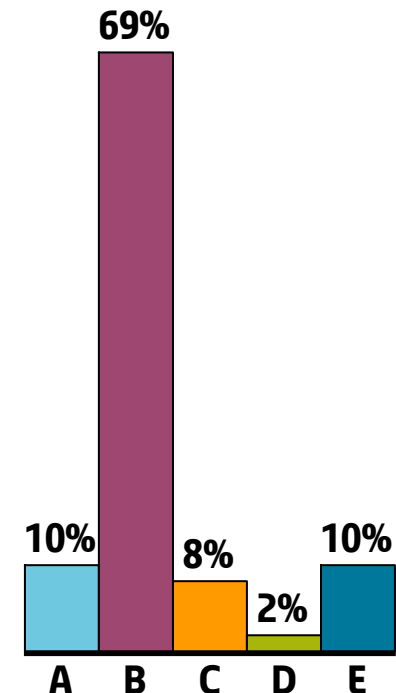
# How many uses are you considering to evidence compliance with the requirements?

- A. 0 - 3
- B. 3 - 10
- C. 10 - 15
- D. Greater than 15
- E. We are not sufficiently progressed to identify a number.

17 MAY RESULTS



18 MAY RESULTS



**SYNDICATE 999**

**RISK APPETITE**

# Syndicate 999 – Reminder of Characteristics

- Gross premium income = £350m,
- ICA = £200m
- Net claims reserves = £500m
- Four main classes of business
- Newly formed Risk Committee, meeting since October 2010, reporting to the Board, chaired by the CEO.
- Board consisting of 4 Execs, 2 INEDs, 1 Group NED.
- Risk Management Function reports via the CRO, a Board member.
- Co-source arrangement for Internal Audit
- Managing agency of Syndicate 999 has an overseas parent and a mix of corporate and private capital providers

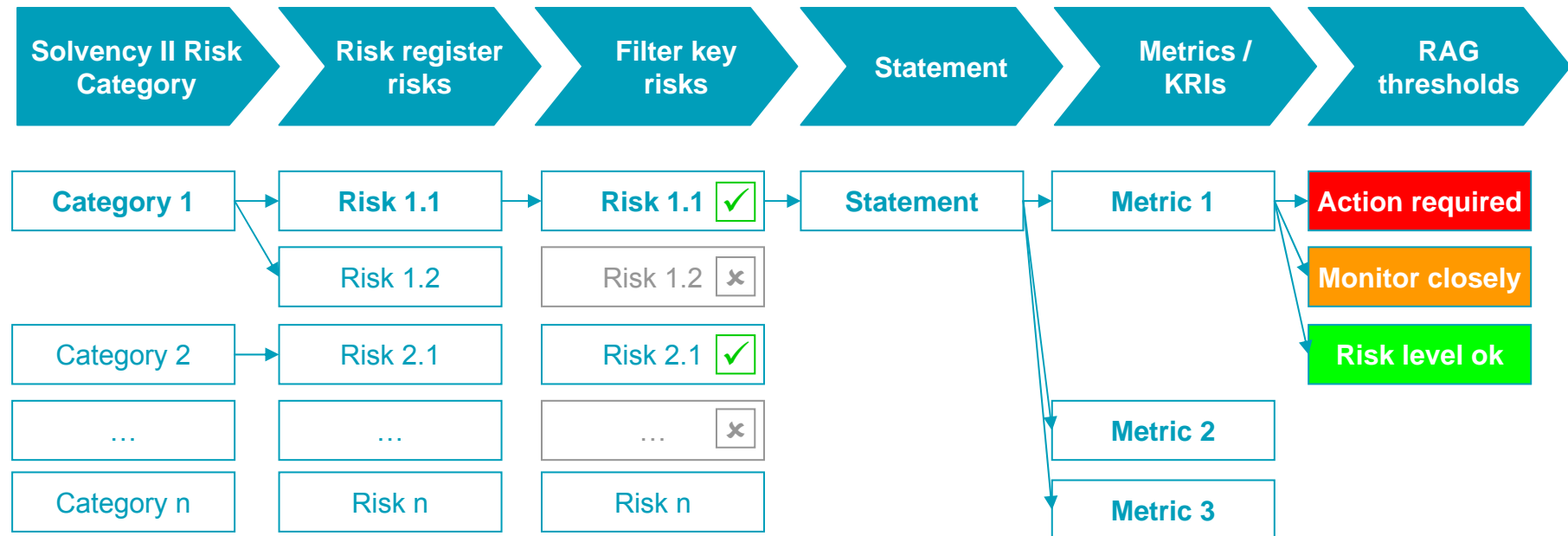
# Risk appetite – Overall approach

- An articulation of the target level of risk for the business
  - Linked to the strategic aims of the firm
  - Defined via a set of “statements”, each with associated “metrics”
- Each key risk area has a defined level of risk appetite
  - Aligned to Solvency II capital setting categories
  - Focus on material risks (not every risk on register has an appetite)
  - In some cases, more than one statement applies to a single risk
- Monitored through regular management information
  - Risk dashboard which is intended to highlight to the Board/senior management where its focus should be.
  - Detailed information is included within routine reporting
  - Quantitative and qualitative measures used and have associated RAG indicators



# Risk appetite – Define framework

## DETAILED RISK APPETITE STATEMENTS...



## ...SUPPORTED BY A CLEAR GOVERNANCE FRAMEWORK





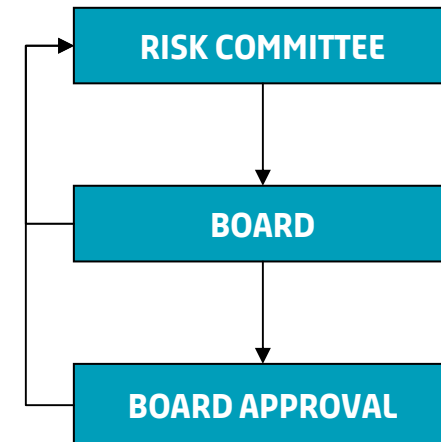
# Risk appetite – Example

<b>SOLVENCY II RISK CATEGORY</b>	<b>UNDERWRITING</b>
<b>INDIVIDUAL RISKS IN THE RISK REGISTER</b>	<b>INAPPROPRIATE UNDERWRITING ACTIVITIES</b>
<b>RISK OWNER</b>	<b>ACTIVE UNDERWRITER</b>
<b>ROUTINE REPORTING FORUM</b>	<ul style="list-style-type: none"> <li>• <b>UNDERWRITING AND CLAIMS COMMITTEE</b></li> <li>• <b>BOARD</b></li> </ul>

RISK APPETITE	ROUTINE REPORTS	KEY CONTROLS	KEY CONTROL INDICATOR	KEY TO INDICATORS (RAG RATED)		
Aim to make an average underwriting profit of at least 5% return on capacity over a 5 year period	<ul style="list-style-type: none"> <li>• Underwriting Benchmark Pricing Reports</li> <li>• Triangulations</li> <li>• Peer and Independent Review Findings</li> </ul>	<ul style="list-style-type: none"> <li>• Benchmark pricing/ price modelling</li> <li>• Peer review</li> <li>• Independent expert review</li> </ul>	Underwriting as a proportion of modelled technical price (class and syndicate whole account basis)	Any one class underwriting in last quarter at less than 90% of technical price	Any one class underwriting in last quarter at 90% to 95% of technical price	All classes underwriting at at least 95% of technical price
			Proportion of peer reviews completed within required timescale	Less than 90% of required peer reviews completed in 5 days or less	90% to 95% of required peer reviews completed in 5 days or less	More than 95% of required peer reviews completed in under 5 days
Our maximum net retention any one risk will always be limited to £10m (or currency equivalent). Maximum gross lines will therefore be limited by this and our appetite for reinsurance purchase	<ul style="list-style-type: none"> <li>• Large and 100% Lines Report</li> <li>• Underwriting Income Reports by Class, Performance against Plan</li> </ul>	<ul style="list-style-type: none"> <li>• Maximum net line limits per underwriter</li> <li>• Signed underwriting authority limits</li> </ul>	Net line per underwriter exceeded	Any net line of over £10m	Any underwriter exceeding their maximum net line limit	No line limited exceeded
No appetite for ceding more than 40% of income any one line or class, or of syndicate total	<ul style="list-style-type: none"> <li>• Large and 100% Lines Report</li> <li>• Underwriting Income Reports by Class, Performance against Plan</li> <li>• Class Underwriter reports</li> <li>• Reinsurance Resume</li> </ul>	<ul style="list-style-type: none"> <li>• Reinsurance purchase strategy</li> <li>• Reinsurance manager monitoring</li> <li>• Peer Review</li> </ul>	Percentage of income spent on reinsurance, by line, class or whole account	more than 40%	35% to 40%	less than 35%

## Risk appetite – Debate and Approve

- Several iterations undertaken with the Risk Committee
- Board presented with following information for each statement:
  - Risk area
  - Specific risk
  - Risk appetite statement
  - Metric
  - Supporting data
- Board went through 2 iterations of information prior to approval.







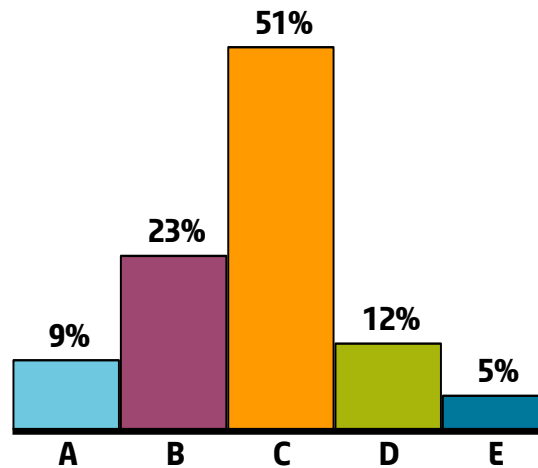
# Risk appetite – Monitor

	RISK AREA	RED	AMBER	GREEN	OWNER
INSURANCE RISK	TECHNICAL PRICING			98.1%	ACTIVE UNDERWRITER
	PEER REVIEWS COMPLETED	55% IN MARINE LIABILITY UNIT	93% ON SYNDICATE WHOLE ACCOUNT BASIS		
	MAX NET LINES	\$21M; MARINE CARGO	\$21M: F BLOGGS		
	40% LIMIT ON R/I SPEND	42% IN MARINE LIABILITY ACCOUNT			
	PORTION OF INCOME ON DELAYED BORDEREAUX		7.3%		
	INCOME AGAINST PLAN	26% BELOW SYNDICATE	20% ABOVE PROPERTY TREATY, 20% BELOW ON MARINE LIABILITY		
CREDIT RISK	AGED PREMIUM: OVER 6 MOS, 3-6 MOS, UNDER 3 MOS	15%	30%	55%	FINANCE DIRECTOR
	UNAPPROVED INTERMEDIARIES			NIL	
MARKET RISK	PROPORTION OF EQUITIES		19.50%		
	PROJECTED RETURN		3.50%		
OPERATIONAL RISK	IT DOWNTIME			NO MATERIAL FAILURES	IT DIRECTOR
	NUMBER AND QUANTUM OF COMPLAINTS		5		COMPLIANCE OFFICER
	ADVERSE FINDINGS FROM REGULATORY REVIEW			0	

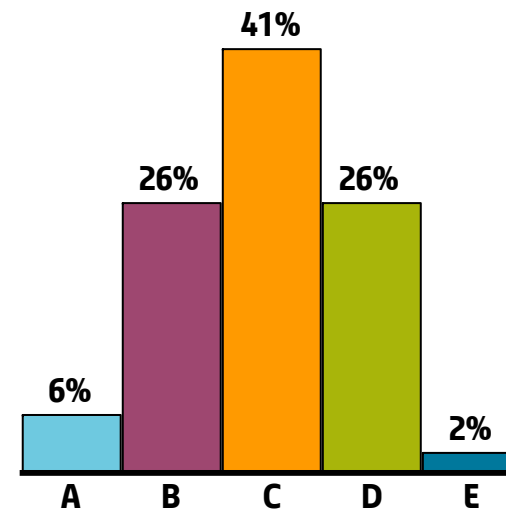
# On the basis of the evidence provided, where would you score Syndicate 999 on risk appetite?

- A. 6
- B. 7
- C. 8
- D. 9
- E. 10

**17 MAY RESULTS**

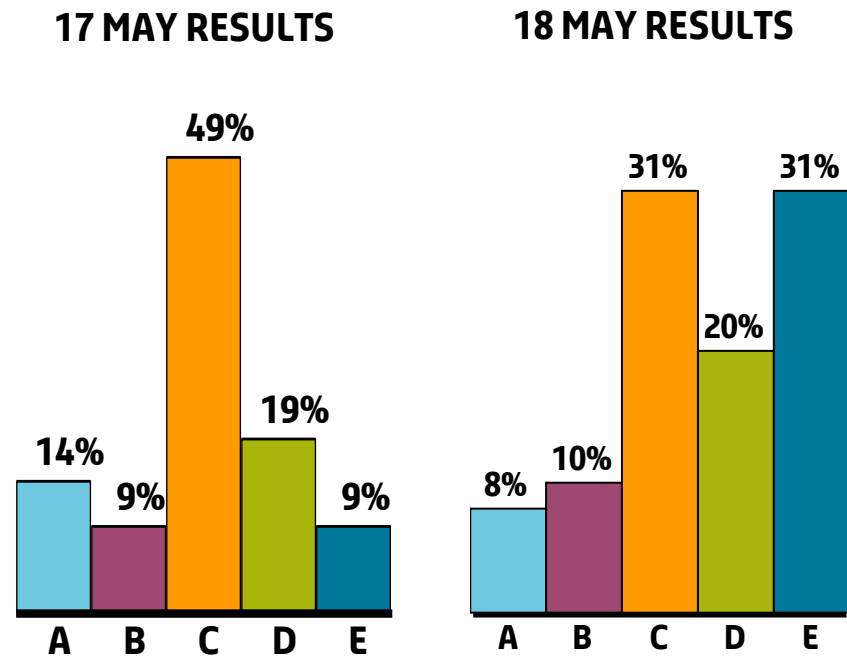


**18 MAY RESULTS**



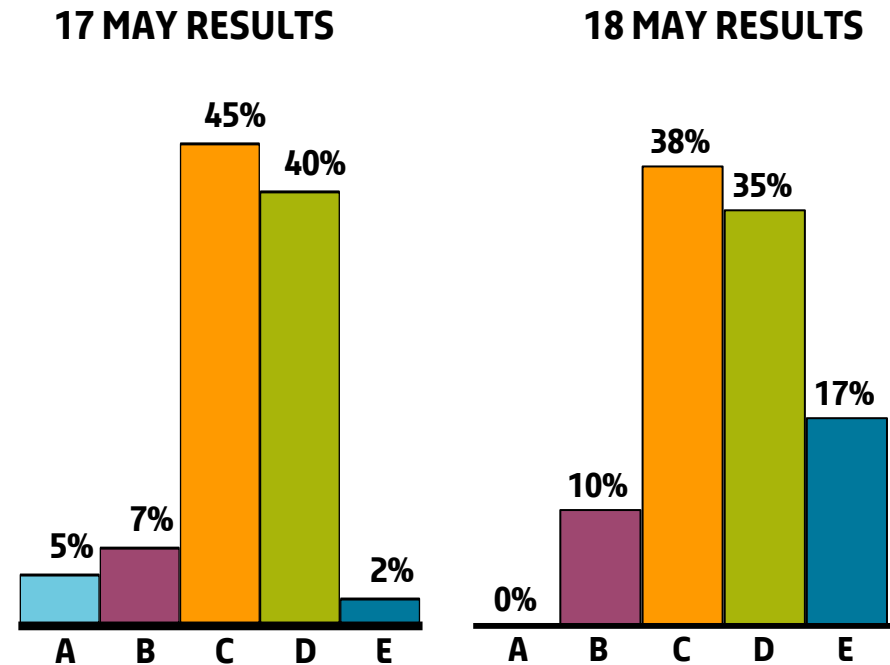
# Which element of the risk appetite framework implementation is causing most issues?

- A. Defining an overall risk appetite statement
- B. Defining the associated key risk indicators
- C. Agreeing on appropriate risk tolerances
- D. Developing robust committee reporting
- E. Getting it all done in time!



# How many risk appetite metrics are you currently proposing that your Board actively monitors?

- A. 0 - 3
- B. 3 - 5
- C. 5 – 10
- D. Greater than 10
- E. We are not sufficiently progressed to identify a number.



# **GROUP DISCUSSIONS**

# Suggested topics for discussion

- What approach have you undertaken to risk appetite definition?
  - Are there alternative approaches to those outlined
  - How well progressed is committee reporting
- What progress has been made in evidencing compliance with Use Test requirements?
  - Definition of uses
  - Agreeing key areas and defining appropriate processes
- What other areas in relation to Governance, Risk Management and Use and proving problematic?
- How well defined is the model governance process?

# **ROUNDUP AND QUESTIONS**

**NEXT STEPS**



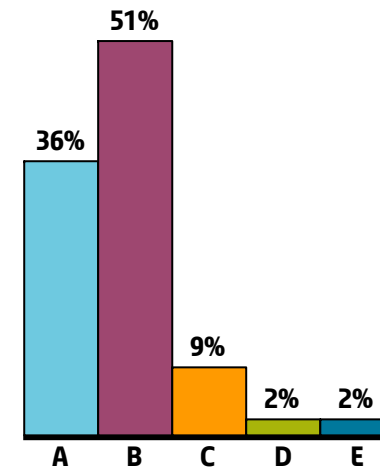
# Next Steps

- Slides will be made available on [lloyds.com](https://lloyds.com) after both workshops
  - ideas welcome via your account manager, risk executive or via [solvency2@lloyds.com](mailto:solvency2@lloyds.com)
- Updated Q1 scores will be reviewed and questions raised with agents together with any request for supporting evidence/rationale
- Second iteration of Governance, Risk Management & Use evidence templates due end June
- Next Governance, Risk Management & Use workshops – 23 & 24 August
- Other upcoming sessions:
  - IMSCR & TPs – 13 & 17 June
  - Balance Sheet & Reporting and Disclosure – 22 & 23 June
- Finally, before you go, a request for feedback ...

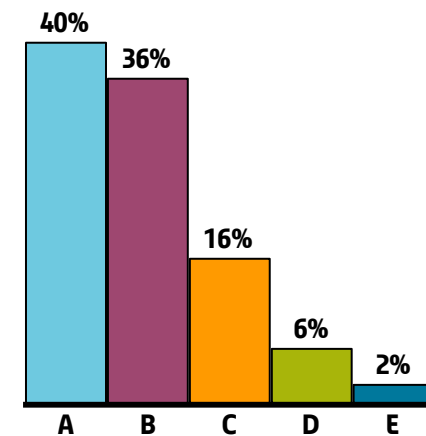
# How useful have you found today's session?

- A. Very useful and we have clear expectations for the next 3 months.
- B. Useful, but greater technical guidance would have been beneficial.
- C. Useful, but greater detail on exact timing of reviews needed.
- D. Not very useful.
- E. I'm too polite to say!

**17 MAY RESULTS**



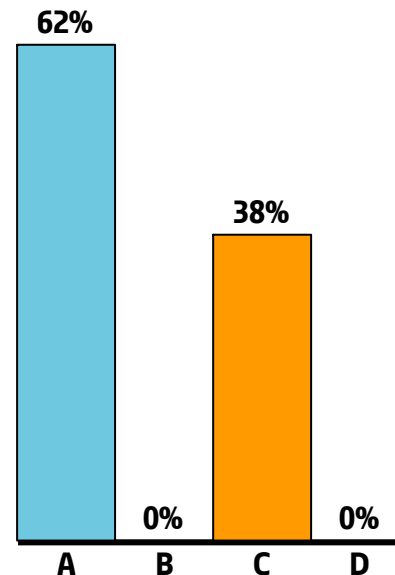
**18 MAY RESULTS**



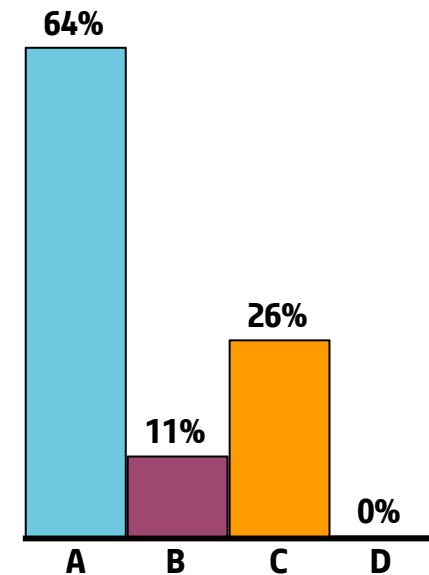
# How have you found format of today's workshop?

- A. It was a good balance between presentation and discussion
- B. Would prefer less presentation and more discussion
- C. Would prefer less discussion and more presentation
- D. Other.

**17 MAY RESULTS**



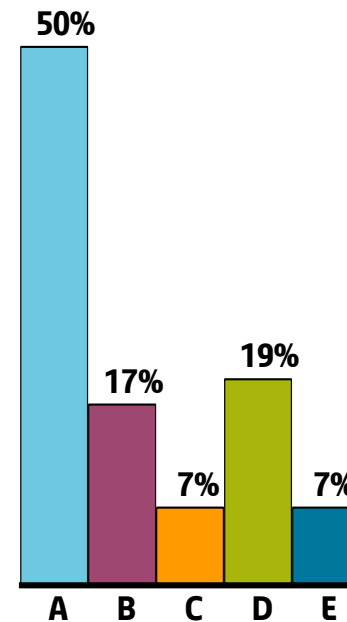
**18 MAY RESULTS**



# What is your view on the review approach?

- A. Structure of reviews has worked well and clear feedback provided
- B. Would expect more detailed questions at this stage
- C. Would expect less detailed questions at this stage
- D. Too much focus on documentation versus discussions
- E. I am not clear on feedback or outcome of review

17 MAY RESULTS



18 MAY RESULTS

