

GOVERNANCE, RISK MANAGEMENT & USE (GRMU) WORKSHOP

2 & 3 July 2012

Agenda

- Introduction & update
- ORSA
- GRMU Follow-up activity
- Model Scope & Model Change

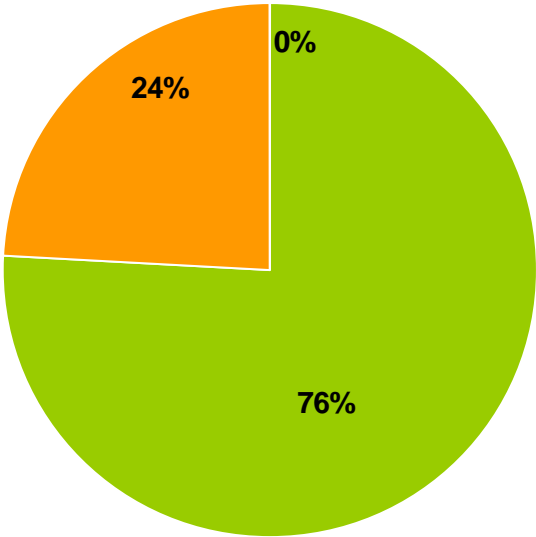
Table discussions

- Q3 & Q4 2012 GRMU activity
- Next Steps

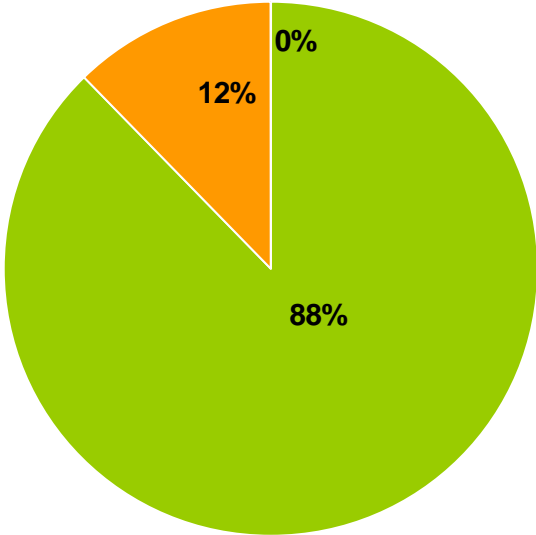
INTRODUCTION & UPDATE

Agent Ratings Summary at end June 2012

By agent

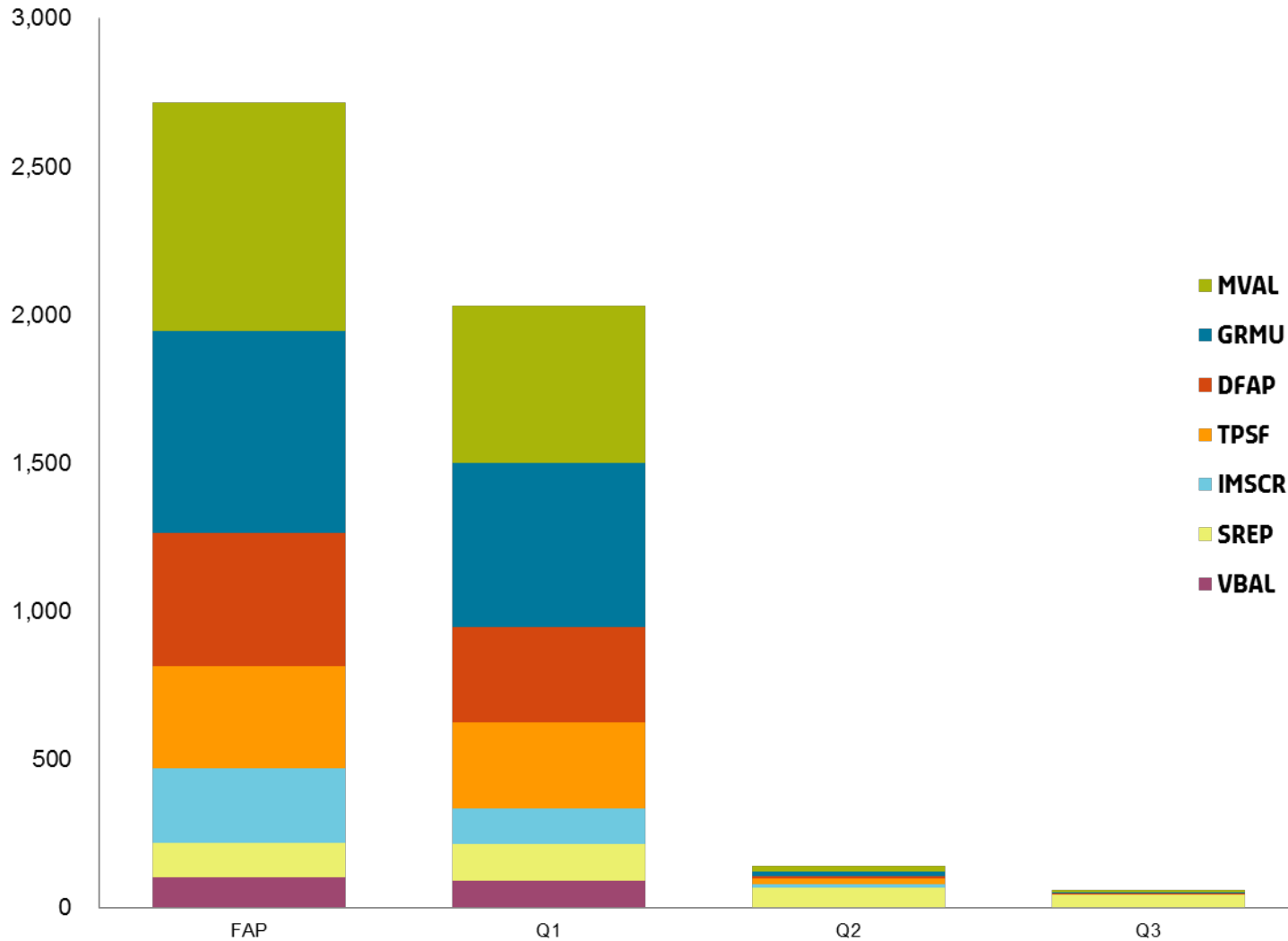


By Materiality
(2012 ICA)

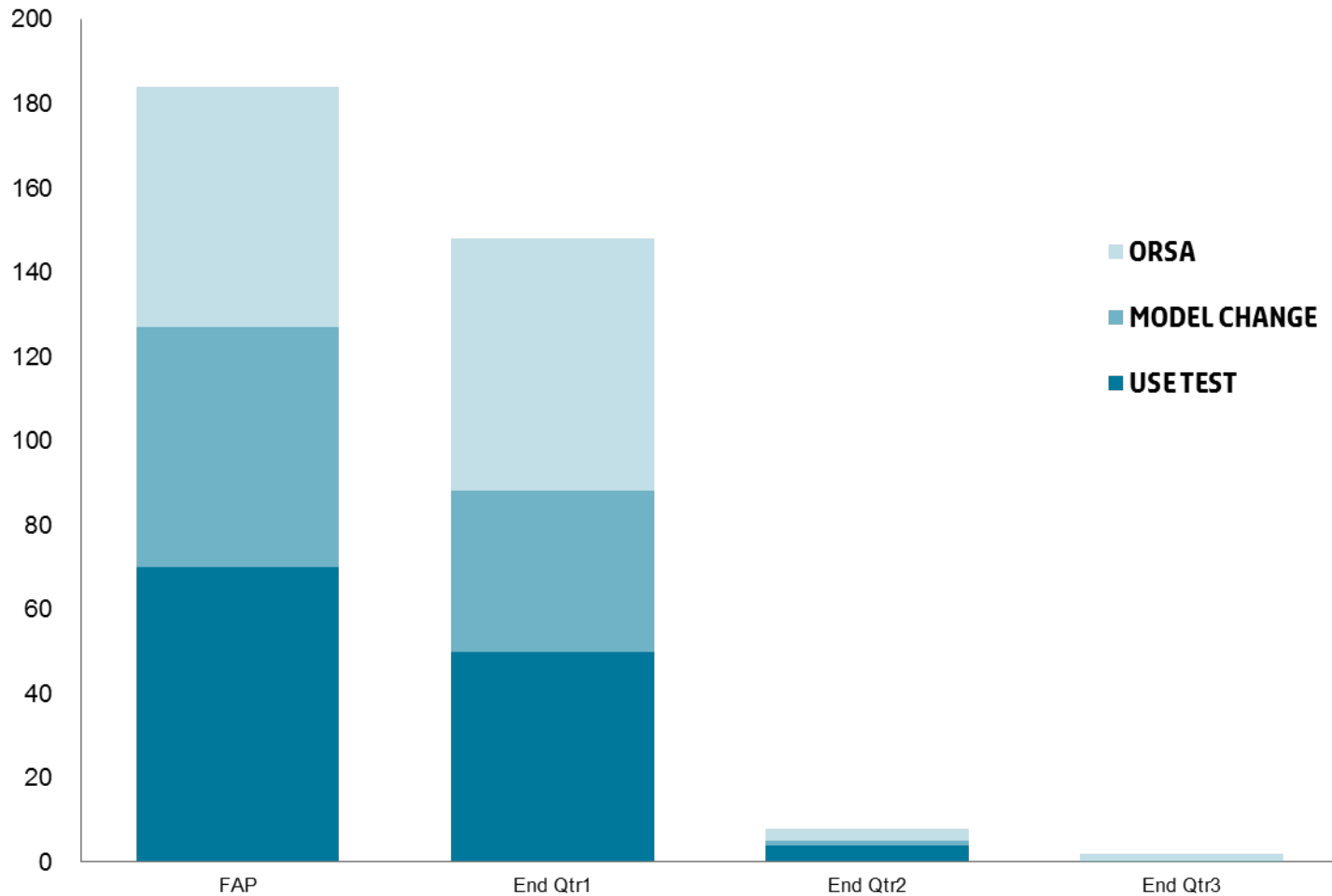


Rating	Summary
Green	Will meet provided that
Amber	Will not meet unless
Red	Will not meet unless with material concerns/FAP rejected

Open gaps reported and projected by agents



Some GRMU sub categories are closing later than others



ORSA

Own risk and solvency assessment feedback

- ✓ First submission
- ✓ Coverage of regulatory requirements
- ✓ ORSA Policy
- ✓ Short term capital planning
- ✓ Senior Mgt/Board involvement
- ✓ Recognition of progress and work to complete
 - ✓ Process will take time to embed
 - ✓ Good practice still being defined
- ✗ Basic information not always included
- ✗ Syndicate level information
- ✗ Conclusions from process
- ✗ Stress & Scenario testing
- ✗ Forward looking perspective
- ✗ Assessment of capital
- ✗ Links to risk appetite/monitoring
- ✗ Reliance on underlying documentation

Recap on ORSA Guidance

Key Principles of May 2012 guidance:

- Syndicate focus
 - Clear conclusions and management actions
 - Detailed capital assessment
 - Stressed risk and capital profile
 - Board approval
 - Clear use of the ORSA in management decision making
 - Format and length
- Long term plan contained in December 2011 ORSA will require affirmation in the September 2012 SBF
 - Our on-going discussions of ORSA feedback with relevant agents has evidenced continued positive development

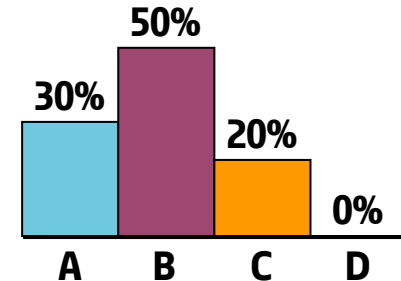
ORSA – What next?

- Those resubmitting at end of June will receive an updated FAP review sheet in July/August
- Resubmission reviews will focus on the critical and material issues raised as part of the FAP review
- Re-affirmation required to support final SBF submission in September, or re-submission if major changes have occurred
- Embedding/Knowledge of ORSA to be picked up as part of Use Test/Embedding activity through remainder of year

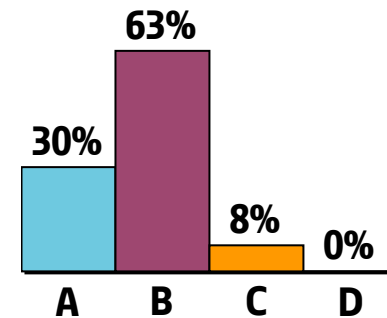
Was the ORSA Guidance helpful in meeting the FAP feedback?

- A. Yes – ORSA guidance is clear and we have dealt with all feedback
- B. Yes – ORSA guidance is clear but we are still working on developing the ORSA in line with feedback
- C. No – ORSA guidance was lacking in a number of areas but we have continued to develop the ORSA in line with individual feedback
- D. No - Guidance and feedback has been insufficient to help develop the ORSA

2 JULY RESULTS



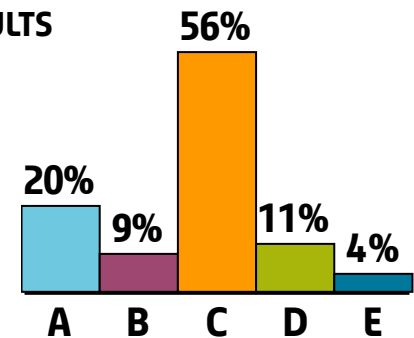
3 JULY RESULTS



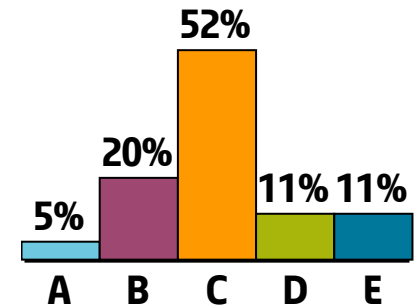
Which area of ORSA development is still causing the most problems?

- A. Risk appetite
- B. Stress & Scenario Testing
- C. Forward looking assessment
- D. Senior Management engagement
- E. Something else

2 JULY RESULTS



3 JULY RESULTS



GRMU FOLLOW-UP ACTIVITY

2011 Follow-up Reviews

- 2011 GRMU Review Reports Followed-up during Q2
- Final Follow-up Reports issued during June and July
- Expectation of closure of all material recommendations – contribute to determination of remaining ‘gaps’
- Remaining items carried forward to Business as Usual

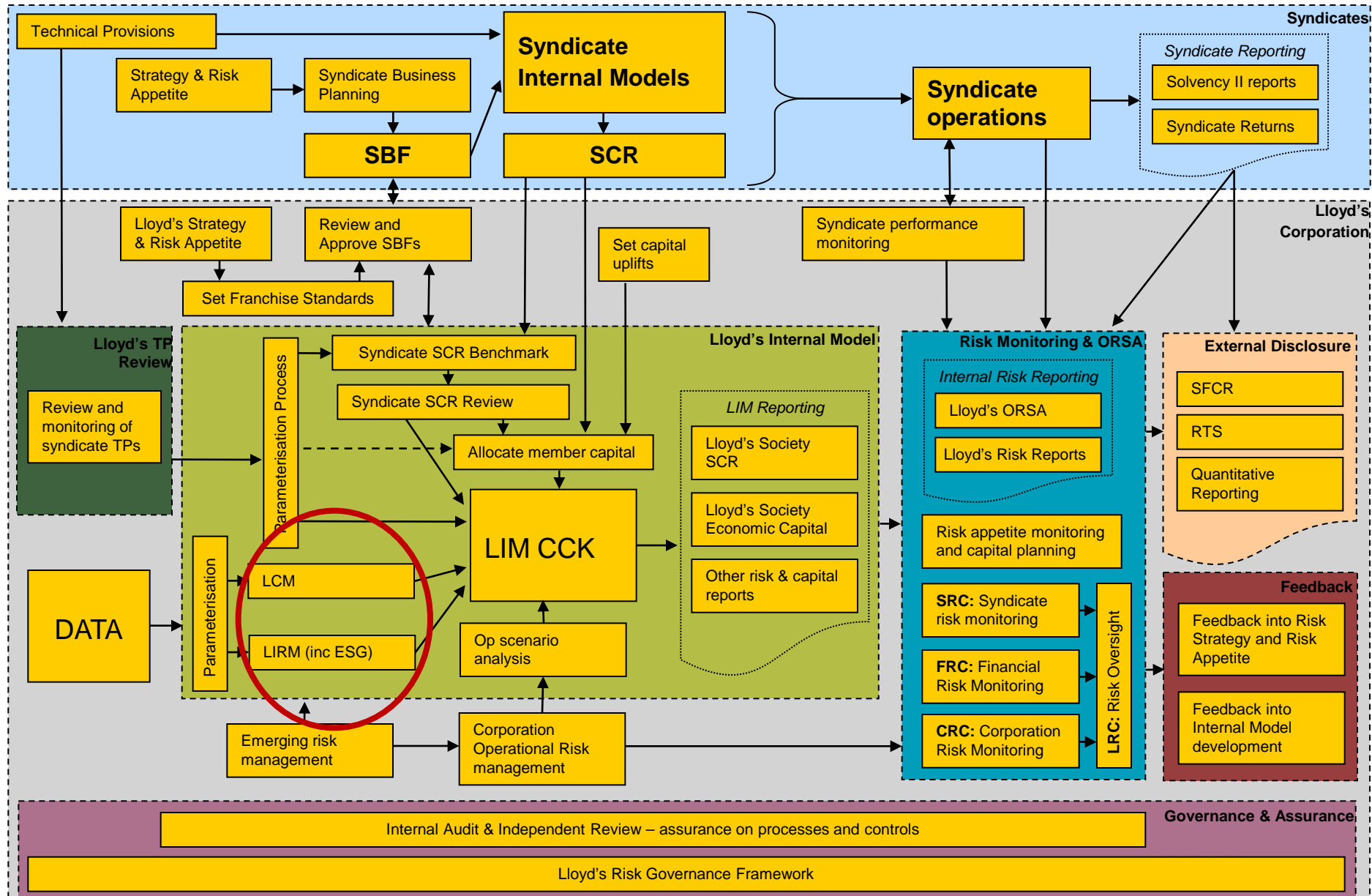
MODEL SCOPE & MODEL CHANGE

Model Scope and Model Change walkthroughs

- All agents met during June/ early July
- Definite improvement in policies following FAP reviews – most feedback now resolved
- Individual agent feedback following the walkthroughs will be provided during June and July. However:
 - Some uncertainty regarding Level 3 regulatory requirements

MODEL SCOPE

Lloyd's – LIM scope



Themes from Model Scope walkthroughs

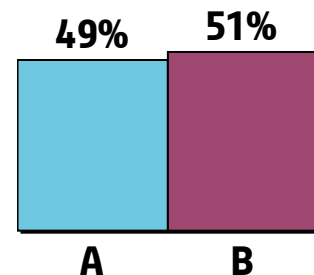
- Some diversity in agents' scopes
- Diverse definitions for the inclusion of 'Parameters' in scope
 - Implications for model change
- Rationale and documentation supporting scope design is often absent
- External models
 - Cat Models
 - ESGs
- Scope Extensions
 - Agents' governance may be similar to Major Change but clarity needed in policies that extension is not a 'change'

Given we have already mandated inclusion of Cat and ESG models, should Lloyd's mandate additional elements of model scope to try to bring more consistency/ equity, e.g. Liquidity risk?

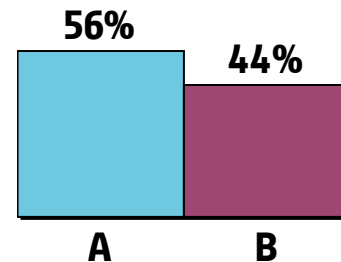
A. Yes.

B. No.

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3 JULY RESULTS



MODEL CHANGE

Major Changes – Diversity in approach

Draft Level 2 text:

‘Major changes to the internal model will need prior supervisory approval...’

- Major Change Threshold
 - Quantitative indicators, but what about qualitative? – sound governance is needed
- SCR trigger level application to:
 - Last agreed 1 year (as a minimum)
- Differing methods of applying the Major Change Trigger
 - Risk category
 - SCR sensitivity post change
 - Syndicate specific basis

'Back-testing' will be necessary

Draft Level 3 text:

'A way for undertakings to “back-test” the scope of their model change policy in general and the definition of major changes in particular could be to evaluate the model change policy in the light of past model changes.'

- FSA feedback
- A number of agents have undertaken some form of back-testing and documented it in their policies
- Particularly useful for:
 - Justifying the Major change to SCR threshold
 - Providing worked examples of what might constitute a Model Change (Major/ Minor) or Model Extension

Parameter Change – Further guidance awaited

Draft Level 3 text:

‘The regular update of parameters will fall into the scope of a model change.’

- Lloyd’s has provided feedback to EIOPA on this - final guidance is awaited
- Differing definitions of Parameter Change
 - Data / Methodology / Assumptions
- Maybe a concession to group parameter changes to alleviate burden of gross aggregation

Risk Profile Change

Draft Level 3 text:

‘ The model change policy will for instance, but not limited to, cover changes in the following areas.....:

Nature, scale and complexity of the risk profile (including material changes in business model, business strategy, products and lines of business, emerging risks, asset management policy and any other relevant changes to the risk profile).’

- Differing definitions of Risk Profile Change, in so far as it means ‘Model Change’
 - Data / Methodology
- A change to risk profile will likely necessitate a change to parameters – treatment of both is therefore subject to further guidance
- We will develop our approach to link model change and SBF change

Aggregating Minor Changes - most common area of discussion during walkthroughs

Draft Level 2 text:

'...Minor changes to the internal model shall be communicated in a summarised report that describes both the quantitative and qualitative impacts of each change and the cumulative quantitative and qualitative effects of the changes on the approved internal model.'

- Clear that further guidance is needed in this area
- Our current thinking:
 - Accumulate from last agreed SCR (may be up to a year, depending on interim Major Change approvals)
 - Aggregate on an absolute, or gross basis (+5% and -5% = 10%)
 - Aggregate across change types

Documenting Changes – an area for development

- Given nascent process, many agents have yet to establish adequate template documentation for change requests and model change logs
- Possible 2 step process, especially in larger agents
 - 1- Request for resource to investigate benefits/ effect of change
 - 2- Request for actual change

Reporting changes to Lloyd's

Lloyd's 2012 SCR Guidance:

- **Scope and Change Policies to be 'live' following July SCR to allow a supplementary paper to be provided with September SCR setting out Major changes**
- **Assessments of change between July and September SCR should be organised between model changes and adjustments to model inputs (e.g. planned premium income)**
- Lloyd's will define a process for business as usual reporting of all model changes with effect from 1 January 2013
- Reporting to Lloyd's
 - We will publish a template for reporting of Major and Minor changes and Scope Extensions
 - Initial handling by current Account Manager - they will co-ordinate further review by SMEs

Other Themes

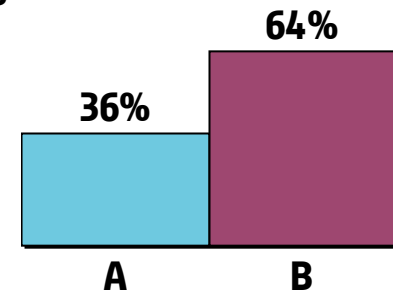
- Diverse range of opinion of how many Major and Minor Changes are expected
- Diverse range of development of approaches – consistent with levels of development and use of capital models
- Adequate governance needed around **all** changes
- **All** changes will need to be reported as either Major or Minor
- Changes to Model Scope and Change **Policies** will also require approval

Do you have analysis to support your currently defined SCR threshold for a major change – ‘Back-testing’?

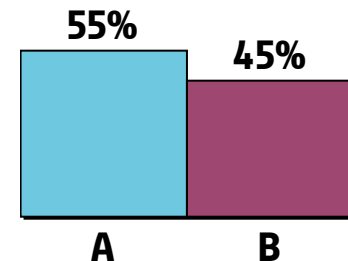
A. Yes.

B. No.

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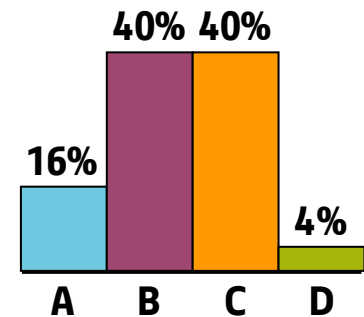
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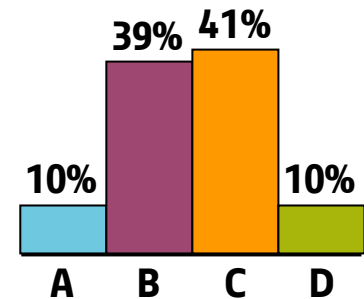
How many Major model changes do you anticipate?

- A. More than 2 per year
- B. Between 1 and 2 per year
- C. Less than 1 per year
- D. Less than 1 every 2 years

2 JULY RESULTS

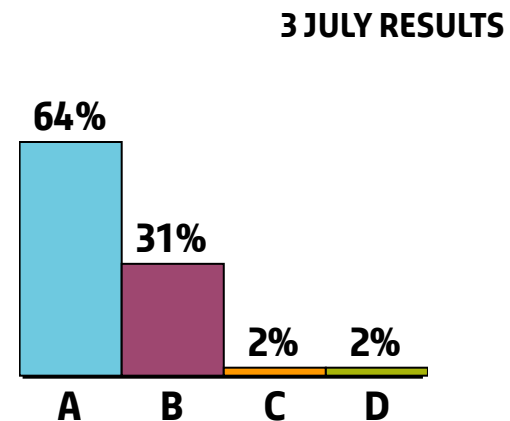
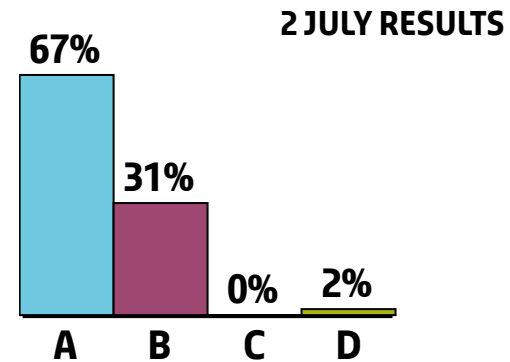


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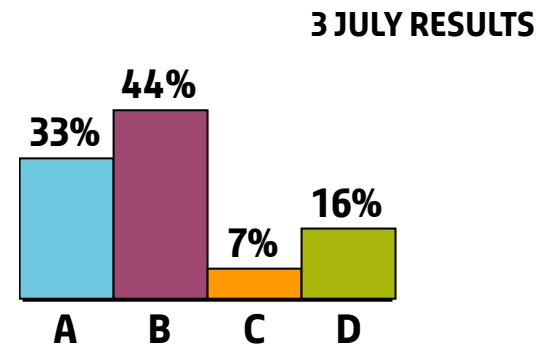
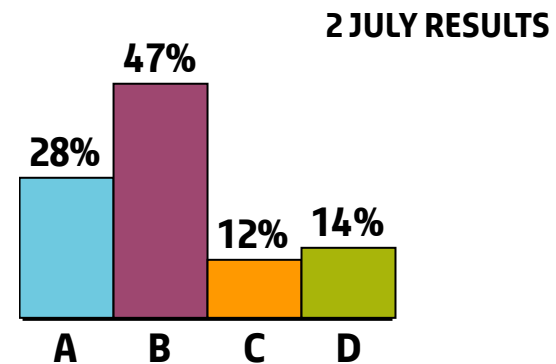
How many Minor model changes do you anticipate under the current version of your Model Change Policy?

- A. Less than 10 per quarter
- B. 10 to 50 per quarter
- C. 50 to 100 per quarter
- D. More than 100 per quarter



How many Minor model changes would you expect if you had to assume all parameter changes are included (but assuming some grouping of related parameters)?

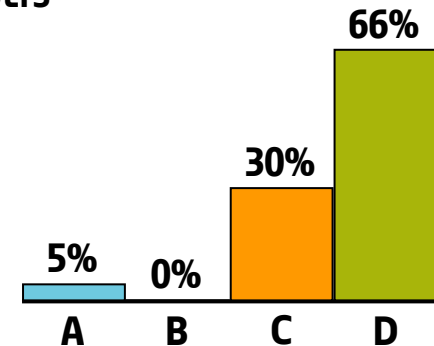
- A. Less than 10 per quarter
- B. 10 to 50 per quarter
- C. 50 to 100 per quarter
- D. More than 100 per quarter



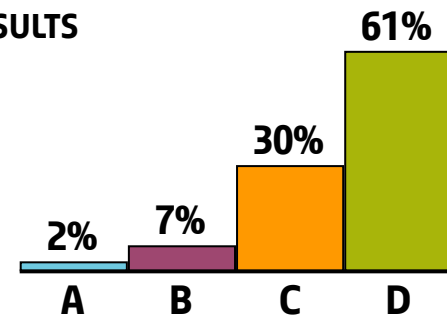
What do you consider to be a reasonable Service Standard for Lloyd's consideration of Major Model Changes?

- A. Within 6 months (EIOPA quoted limit)
- B. 3-6 months
- C. 1-3 months
- D. Less than 1 month

2 JULY RESULTS



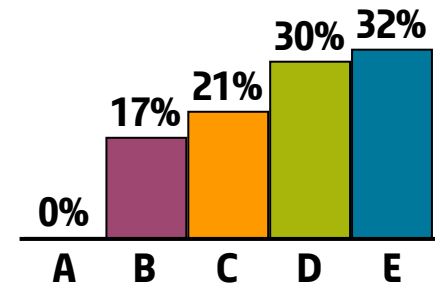
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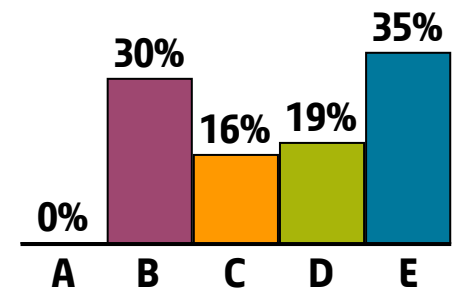
At what stage are you at in implementing your approach to model change?

- A. Still being designed
- B. Fully designed but needs implementing
- C. Partially implemented
- D. Fully implemented and ready for first change
- E. Fully implemented and we have changes going through the process

2 JULY RESULTS



3 JULY RESULTS



GROUP DISCUSSIONS

Suggested topics for discussion

- Rationale for model scope
- Change trigger levels and back-testing
- Aggregation of minor changes
- Parameter updates/risk profile changes

Q3 & Q4 2012 GRMU ACTIVITY

Q3 Activity

- Individual agent feedback on Model Scope and Model Change Walkthrough
- Further consideration of Market Guidance on Model Scope and Model Change
 - predicated by the need for clarity on the Solvency II regulations/ Level 3 text in this area
- Remaining final follow-up review reports issued
- Review of Operational Risk Methodology in July SCRs
- Review of resubmitted ORSAs and Evidence Templates
- Planning for Use Test and embedding reviews

Q4: Use Test & Embedding reviews

- Two key elements to review
 - Review of documentation supporting Use Test compliance
 - Interviews with directors (and possibly other staff)
- As far as possible we will use documentation already provided
 - Where necessary, additional documentation will be requested during Q3
- Interviews expected to start in September
 - We will endeavour to co-ordinate these meetings with similar plans by FSA
- Interviews likely to last 60-90 mins and focus on:
 - Individual's knowledge of Solvency II and agent's approach to it
 - Changes brought about by the Solvency II project
 - Knowledge and understanding of new MI and of accountability for risk management
 - Use of MI in decisions

NEXT STEPS

Next Steps

- Slides will be made available on lloyds.com after both workshops
- ORSA resubmissions for some agents received 29 June
 - Feedback to be provided during July/August
- GRMU evidence template re-reviews on-going
- Individual agent model change feedback to be provided during July (but subject to future change as above)
- We will endeavour to issue further market guidance on model scope and model change once more clarity is available through the Solvency II text
- Other upcoming sessions:
 - Documentation & Final Application – 17 & 18 July and then none currently scheduled until November on SREP
 - Any additional sessions you would like to see?

