GIRO Conference and Exhibition 2012
Juggling uncertainty the actuary's part to play

20 September 2012

GIRO Conference and Exhibition 2012
Workshops D5 & E8

Lloyd’s Update

Henry Johnson
Jerome Kirk
Matthew Gold

20 September 2012
Agenda

• Half Year Results
• Vision 2025
• Solvency II
  – Corporation
  – LIM Operating Model
  – Syndicate requirements
  – Actuarial Function / SII TPs
• BAU
  – Capital
  – Reserving

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Vision 2025
• Initiative has come from the top of the organisation
• Chairman and CEO have consulted directly with the market
• Vision requires both corporation and market to look forward
• Need to turn ideas into practical things

Lloyd’s and the Future – V2025

• Broker subscription market
• “Lloyd’s business”
• Global diversity – business, businesses, people
• Face to face
• Same capital structure
• Need to be proactive to achieve this – same size market will not be same market, as different regions grow
Solvency II Corporation

- Internal Model submission made 27 July 2012
- Currently in review phase of FSA workplan
- Expect interim findings end 2013Q2
- Attest to FSA at end of December on syndicate compliance
- Collaborative model validation work
  - CAT
  - ESG
- Syndicate BAU
Solvency II
LIM Operating Model

Franchise Board
Risk Management Function (ERC)
LIM Advisory Board / LIM Manager
LIM Validator

BAU Operation & Use
Change Management
Validation

- Day to day running / USE
- Every time we do something, we must check the answers are valid
- Every year we must formally validate the model
- Sometimes, as part of this, we may want to change something

- Validation Policy
- Annual Validation Report
- Ad-hoc report on Major change
- Informal “validation” occurs throughout the year for answers to specific runs/questions.

Change Policy

2012 syndicate requirements
There are some important dates in October 2012…

**TPSF**
- Technical Provisions and Standard Formulas
  - 12 October (SSG return)

**SREP**
- Supervisory Reporting
  - 31 October (Last documentation)

**MV**
- Model Validation
  - 6 October (Validation Report)
  - 16 October (Briefing)

**DFA**
- Documentation and Final Application
  - 5 October (Final Application)
  - 31 October (Cat documentation)

…with one eye already on the BAU timetable

<table>
<thead>
<tr>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
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<tr>
<td>Jan</td>
<td>Feb</td>
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**Managing Agent**
- Submissions to Lloyd’s
- Business Planning
  - Pre-SBF meetings
  - SBF review
  - Incl. ORSA analysis of change
  - Business plan approval

**Lloyd’s**
- SSG: Quant review
  - Quant review
  - ORSA activity
  - ORSA Review Report

- SSG: Qual review
  - Qual review (non-ORSA)

- Society ORSA
  - Qual review (non-ORSA)

- ILIM
  - ILIM use

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Solvency II Standard Formula at Lloyd’s

- IMAP requires a comparison of Internal Model and Standard Formula results
- QIS5 basis no longer appropriate
- Lloyd’s produced data collection templates for completion by agents; and
- A calculation template to derive the standard formula results—based as closely as possible on the Level 2 text—key change was the new non-life catastrophe risk requirements

The QIS5 specification overstated Catastrophe and Currency risk...

Source: 2019 Year-End QIS5 Re-Run, Syndicate Aggregate Results (i.e. PTF)
…but the Level 2 insurance risk mix (not quantum) does seem more appropriate.

But the currency risk charge is still high.

Source: Preliminary Results from the 2011 Year-End Standard Formula Exercise on a Level 2 basis, Syndicate Aggregate Results (i.e. PTF)
Lloyd’s collected draft Actuarial Function Reports from the market in 2012

- Reviewed against draft level 2 requirements
  - not “for real” - could have placeholders
  - looking for up to three separate reports
- Feedback produced for agents
  - wide range of approaches and formats
- There were good examples against each requirement
  - experience tells us standards will be high in time
  - not all included the solvency provision results (GAAP focussed)
  - not seen as “document everything done during the year”
  - dry run important step to get process correct
  - TAS compliance will be needed in live environment

Technical Provisions on a Solvency II basis are being produced and used…

![Graph showing Movement of UK GAAP to Solvency II Technical Provisions](Note: Hatched area relates to simultaneous reduction in assets)

Source: 2011 year-end Technical Provisions Data Return
but results continue to vary by syndicate

Solvency II Provisions as Proportion of UK GAAP

Source: 2011 year-end Technical Provisions Data Return

BAU Capital Setting
How will 2013 member capital be set?

Approach and timetable

- Using Solvency II models to meet ICAS requirements
  - equivalence is key

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<thead>
<tr>
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<th>Non-Aligned</th>
<th>Aligned</th>
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<tbody>
<tr>
<td>Initial LCR (SBF 12 July)</td>
<td>19 July</td>
<td>19 July</td>
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<tr>
<td>Final SBF</td>
<td>13 September</td>
<td>13 September</td>
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<tr>
<td>Final LCR</td>
<td>20 September</td>
<td>20 September</td>
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<tr>
<td>Coming into Line</td>
<td>29 November</td>
<td>29 November</td>
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Lloyd’s capital review during 2012

- Full quantitative review by Lloyd’s
  - similar to old ICA reviews (not “light” version)
  - dedicated cross departmental team led by MRC staff
  - SCR documentation and on-site walkthroughs
- LCR return is vital and informative
  - input into Lloyd’s benchmark model
  - updated specification on Lloyds.com
- Qualitative reviews continue throughout the rest of the year
Ultimate SCR plus SII balance sheet provides equivalent policyholder protection as ICAS

Now

- Uplift and Central Assets
- Total 1:200 asset stack

Solvency II

- Ultimate Risk
- SCR (one year risk)
- Solvency II Technical Provisions

What drives the review of the number?

- Non – modelled cat
- Eurozone market risk
- New lines of business
- Reinsurance credit risk

- RDSs
- Loss ratios
- Diversification between risk groups

- Broker credit risk
- Liquidity
- Operational risk

- Reserves
- Diversification between reserves and premiums
- Group and other major reinsurances
Our review will apply Professional scepticism…

- Auditors’ code of conduct
- Goodwill and good intent
- Challenge management assertions
- Factual agreement before conclusions
- Alert to inconsistent responses
- Persistence to reach a conclusion
- Justification of conclusions

…to test credibility and transparency

✔️ LCR and validation / documentation joined up
✔️ Actuals and projections are consistent with explanations for differences
✔️ Reasoned and persuasive responses
✔️ Realistic assessment of 1:200 at risk level
✔️ Prompt supply of available evidence

❌ Inconsistent documents and / or model outputs
❌ History dismissed … “We don’t write that anymore”
❌ Improbably thin tailed risk distributions
❌ Jumble of emails and meeting notes
We have issued updated reserve guidance

The key principles are

- The **Board** of the Managing Agent are **responsible** for setting the reserves of the syndicates.
- The Board should be supplied with **sufficient information**, and especially surrounding key issues and uncertainties, to ensure that they can make an informed decision when setting reserves.
- Managing Agents should have a **robust procedure** for the setting of reserves. This includes ensuring those conducting technical and regulatory aspects of reserving have **appropriate skills and knowledge**.
- Processes surrounding **data** that fits into any reserving exercise should be clear, well-documented and fit for purpose.
- All aspects of the reserving process should be **documented** to a standard such that a suitably skilled third-party person could understand the underlying assumptions and decisions made.
- Lloyd’s oversight of reserves includes regular reviews and analyses such as the relative reserve benchmarking exercise. Lloyd’s will **actively engage** with syndicates in the market and will provide regular communications on reserving topics.
- Where Lloyd’s perceives that a syndicate may have an inadequate reserving process or practice then Lloyd’s may **impose some actions** against the syndicate such as explicit capital loads or more stringent reporting. However such actions would be expected in the extreme.
And will be updating the VoLs

- Executive summaries in reports worked well
- New Valuation of Liabilities rules will be issued within the next few weeks
  - no major changes expected
  - do read the FAQs
  - Signing Actuaries forum on 5 December
    - any topics let us know
  - Do want to see explicit mention of items such as PPOs and discounting
- Peer review is important
  - we may want to talk to the peer reviewers

Looking forward to year-end

- Catastrophe losses will impact the year-end
- No new reserving “hot topics” have emerged …
- …. but last year’s do remain
  - UK Motor
  - Italian Hospitals
  - Casualty and the cycle
- Monitoring and understanding reserving remains vital
  - at the same time as transitioning to the new regime
Planned year-end submission dates

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<td>12 February 2013</td>
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<td>SAO Reports</td>
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- Please submit two copies of the SAO report
  - one of which must be a hard copy, electronic copies are encouraged
  - reports to Jerome Kirk, Market Reserving & Capital, G5, Lloyd’s, One Lime Street, EC3M 7HA,
  - submit electronic copies via email to SAOReports@lloyds.com

Questions or comments?

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