Lloyd’s Update – GIRO 2019
25/09/2019

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“It is not capital efficient to do business at Lloyd’s anymore”

“Appeals are a free roll of the dice, you’ve got nothing to lose”
Word on the street
Overheard in Leadenhall Market…

• “Lloyd’s just want more capital so are looking for excuses/opportunities to add on rather than taking an objective approach to reviews”
  • We take a bottom-up approach to capital setting – it is in no way an allocation of a targeted capital amount.
  • In regards to add-ons (of capital loads), we require response to uncertainty as it is shown in experience
  • Don’t approach arbitrarily, driven by our inability to justify internally that these areas of uncertainty have been suitable addressed based on the information we are provided with

• “It is not capital efficient to do business at Lloyd’s anymore”
  • Benefits of chain of security and mutual structure
  • Provides access to Lloyd’s credit rating and international licenses
  • Feedback on this invited for Future at Lloyd’s consultation
Word on the street

Overheard in Leadenhall Market…

• “Appeals are a free roll of the dice, you’ve got nothing to lose”
  • Syndicates have right of reply before decisions are made in all cases for this year’s reviews
  • We will make clear grounds for decisions and we expect clear grounds for appeal
  • Engaging with us early to provide all context and information should reduce the need for appeal

• “Lloyd’s are too heavy handed and unlikely to accept any pragmatic approach, I wouldn’t talk to them about emerging issues”
  • We won’t prescribe your approach to an issue if you are pro-active in informing us and dealing with it
  • We will accept action plans that appropriately manage risks and are pragmatic
    • We often provide feedback that change plans seem “challenging”
    • We have encouraged more (controlled) use of add-ons/adjustments in briefings this year
  • But we can’t accept incomplete submissions that do not comply with the required regulation
  • If you are not sure please ask us
“An objective test is easier to communicate to the Board”

“Less prescribed intervention would be helpful”

“We value the openness and communication from Lloyd’s this year”

“Lloyd’s has been pretty good at thought leadership to exec and boards.”

“We all need to work together for the sake of the market”
The Prisoner’s Dilemma

A “game” of imperfect information in which your fate depends on the actions of another

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<th>Prisoner 1</th>
<th>Prisoner 2</th>
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<tr>
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<td>-8,-8</td>
<td>-1,-1</td>
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<tr>
<td>Co-operate</td>
<td>-10,0</td>
<td>-10,-10</td>
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**Dominant strategy**: Betray for both players

But this is not the best overall outcome

And is not a dominant strategy in a multi-period iterative game

And is not a solution when can assume others will act logically
The Prisoner’s Syndicate’s Dilemma

A process that is outlined in advance and based on information you provide, allows for uncertainty

We are not in a Prisoner’s Dilemma situation!

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Dominant strategy: Engage early

We have shared the information using to make our assessment(s)

And worked together with the market to improve the tests we apply

We work on the basis that the market will act logically

We continue to ask that Syndicates focus on their risk profile & uncertainty and addressing it appropriately

We can tell when you are solving to our numbers and this will only delay remediation of issues
Measuring Volatility

What we are looking for
Higher or Lower?

Put the below in the order of most to least likely

A. Having a 1 in 15 year followed by a 1 in 16 year followed by a 1 in 18 year

B. Being struck by lightning

C. A 1 in 200 year

D. Randomly selecting a four person board from FTSE 100 board leaders (CEO, CFO, Chair) and all being female
Higher or Lower?

Put the below in the order of most to least likely

Results:

C. A 1 in 200 year

B. Being struck by lightning *(in a lifetime)*

A. Having a 1 in 15 year followed by a 1 in 16 year followed by a 1 in 18 year *(years are independent)*

D. Randomly selecting a four person board from FTSE 100 board leaders (CEO, CFO, Chair) and all being female

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What do we mean by volatility?

You need to articulate sources of variation consistently with modelling treatment and risk profile

What causes outcomes to be different to expectation?

• Your expectation is wrong
• Something happened that you thought was unlikely (bad luck)
• Something happened that you thought was unlikely but you were wrong about how likely it is
• Any combination of the above

What does this tell you about the assumptions in your model?

• Tracking outcomes over time helps to inform this
• Often measures of volatility are based on historical outcomes

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What do we mean by volatility?

Need to articulate sources of variation consistently with modelling treatment and risk profile

Make sure you are seeing the full picture

And connecting this to the representation of volatility in the model…

Sporadic deviation likely to be something you thought unlikely happening

Consistent deviation likely to be starting position (or you are wrong about events being unlikely)

Be careful with statistical tests

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We rely on you to explain experience to us
You need to consider drivers and how they are captured in the model

There is such a thing as bad luck
But please remember:
What are we looking for? Be explanatory, not descriptive

In summary

If you explain movements and features in a way that shows thorough testing, references your risk profile and is internally consistent this will greatly reduce the number of queries we have on your modelling.
What are we looking for?

In detail: Our review template looks to explain model features and movements based on risk profile and more detailed technical review.

1. Which Syndicate is it, what is the capital and how has this moved?
2. What are the return periods of recent years and extreme events?
3. What is the review level and high-level conclusions?
4. What is the breakdown of capital and any issues by risk type?
5. How has the SCR and risk type output varied over time compared to exposure?
6. How does the SCR and risk type output compare to the market over time?
What are we looking for?

Our review template looks to explain model features and movements based on risk profile

2. What are the return periods of recent years and extreme events?
   — If there has been extreme recent experience we need:
     – A reason why this can’t be repeated or was exceptional – remember
     – Adjustment of the model to reflect this

3. What is the review level and high-level conclusions?
   — We undertake a risk-based review that takes account of model drift, stability, outlying experience, change justification/analysis, quality of documentation/validation, other reviews undertaken, other items (governance, reserving, underwriting)
   — The review level is assessed post-submission and adjusted if the submission indicates a different level would be more appropriate. The reason for the review level is included in the summary
   — High level conclusions are drawn linking capital to risk profile:
     – A reduction in premium risk due to reinsurance is appropriate but a further reduction based on generic “risk profile” updates has not been accepted. The reinsurance benefit has resulted in an increase to reinsurance credit risk. Other reduction “as expected” according to syndicate but not substantiated in terms of whether this represents a change in mix, change in view of volatility/correlations and/or new business being written
What are we looking for?

Our review template looks to explain model features and movements based on risk profile

4. What is the breakdown of capital and any issues by risk type?
   — Does the breakdown of capital seem logical in the context of the syndicate risk profile
     — All risks contribute (with clearly defined exception)
     — Absolute values and movement link to risk profile – If it is a large catastrophe writer premium risk makes a high contribution, if reinsurance benefit to capital has increased reinsurance credit risk has increased, if reserve risk volatility has reduced something about the business has become less risky
     — One year and ultimate are consistent and appropriate

5. How has the SCR and risk type output varied over time compared to exposure?
   — Key measures of model drift and movement
   — Comments refer to how this reflects risk profile – you can provide these for us
   — Look at total level versus “objective” exposures – volumes, standard formula LIM view
   — Look at risk type level against risk type exposures (e.g. RI credit risk/RI recoveries) – does this link to evolution of the risk profile
What are we looking for?

Our review template looks to explain model features and movements based on risk profile

6. How does the SCR and risk type output compare to the market over time?
   — Quartiles to provide intuitive check on relativity, not define requirements
     – Do large liability syndicates have high reserve risk?
     – Do syndicates that have operational issues recognise this in their Op Risk?
   — What has moved in the year and is that in line with that syndicate compared to the market
     – Combines views across Lloyd’s teams: PMD, capability etc.
Market-level reserving observations

What we are seeing
Concerns on Casualty continue

At high class of business level evidence of potential market-level deficiencies

Lloyd’s central reserve review exercise identifies potential areas of deficit in held reserves.

- Casualty Treaty
- Casualty FinPro

View based off our best estimate, but a wide range of reasonable alternative views could give rise to different conclusions.

Lower level classes of business Lloyd’s have reserving concerns about include:

- D&O (US and Non)
- FI (Non-US)
- NM GL (US and Non)
Reaction to deterioration

D&O Non-US 2017YE position

Incurred claims

Gross All Incurred Development - All Origin Periods

- 2004
- 2005
- 2006
- 2007
- 2008
- 2009
- 2010
- 2011
- 2012
- 2013
- 2014
- 2015
- 2016
- 2017
- 2018

Development Year

0 1 2 3 4 5 6 7 8 9 10
Reaction to deterioration

D&O Non-US 2018YE position

In incurred claims, deteriorations seen across many years of account. 2011 removed to view deterioration clearer.
Reaction to deterioration

D&O Non-US  Question over adequacy of reserves for recent years of account

- Huge premium growth between 2015 and 2016
  - Transaction business
- With growth continuing
Themes across classes

Question over adequacy of loss ratios for recent years of account

Market held Ultimate Loss ratio example:

- Appropriateness of IELR setting
- Questions over reported rate change and inflation (PMDR)
- Importance of data and allocation to Lloyd’s risk-code!
- Evidence of possible case reserve weakening
Case Reserve Adequacy
Potential evidence of case reserve adequacy weakening

NM GL (US Direct)  
US Medmal

Paid to Incurred Development - Ex-cat

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Appropriate IELR setting

Means that plan and reserving loss ratio assumptions may differ…

…but should be consistent:

- Reduced credibility given to re-underwriting +4%
- Additional uncertainty due to growth in a class +3%
- Different view of expected future claims inflation +3%

To achieve this teams need to work together with strong collaboration and communication. Justification of the bridging between the loss ratio views should be understood by the Board and challenged.

Areas of uncertainty in the reserving and prospective loss ratios assumptions should be explicitly highlighted and incorporated into the capital calculation.
Questions?
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