Lloyd’s Reserving Oversight

What have we focused on over 2022?

SIAS 9 November 2022

Uma Divekar

Our priorities for 2022

These have changed as new uncertainties have arisen over the year

- **Implementation of principle-based approach**
- **Thematic review of social inflation**
- **Continued monitoring of COVID-19**
- **Integration of Actuarial Oversight team**
- **Only actual performance drives your capital and plan**

Our priorities for 2022

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Implementation of principle-based approach

Thematic review of social inflation

Continued monitoring of COVID-19

Integration of Actuarial Oversight team

Only actual performance drives your capital and plan

Economic inflation

Ukraine

Hurricane Ian

Recession / changing interest and FX rates?

Climate Change?

Changes to Lloyd’s Oversight Framework

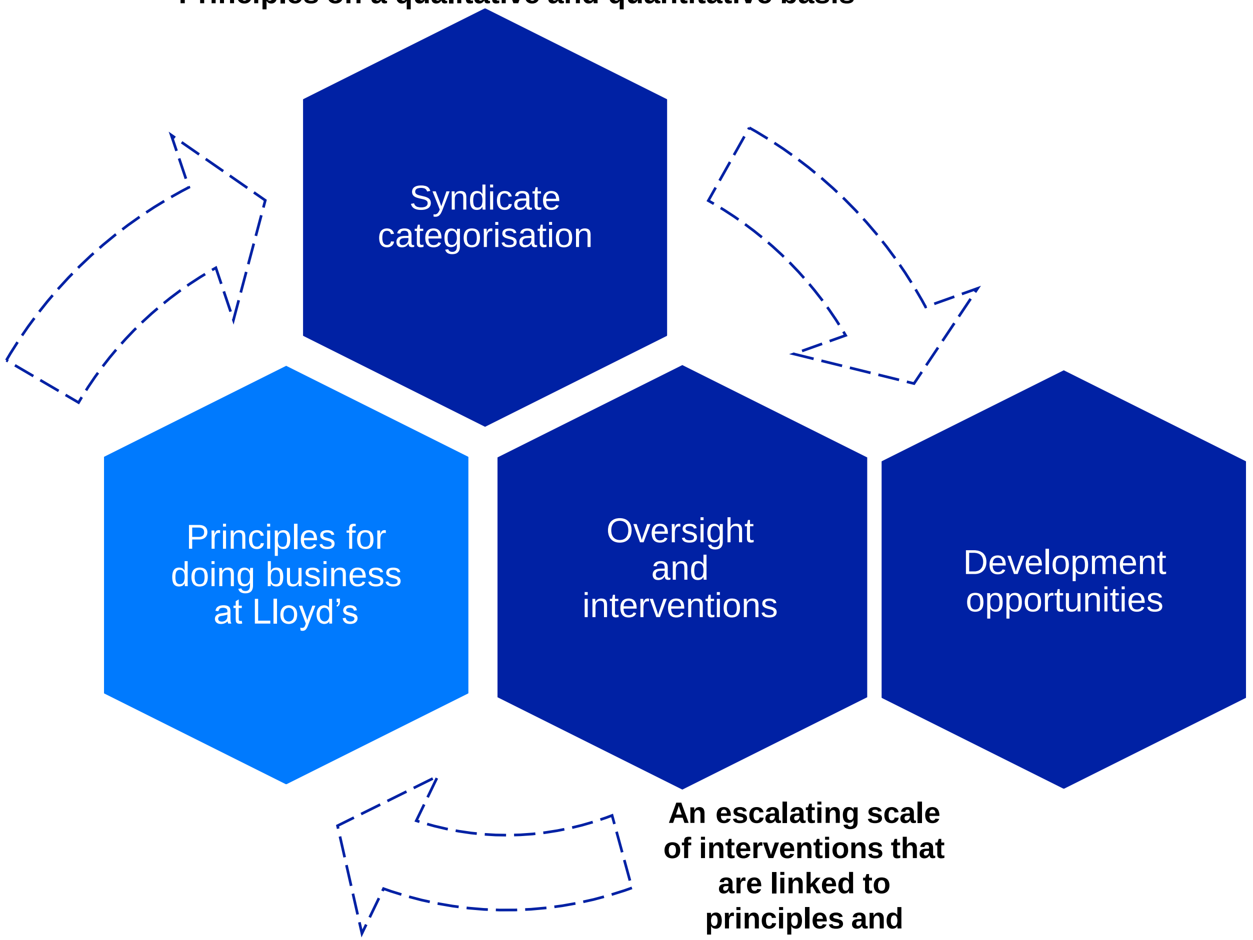
Oversight Framework

Lloyd’s has moved to a principles-based approach

Principles defined across all oversight areas

PERFORMANCE	1. Underwriting Profitability
	2. Catastrophe Exposure
	3. Outwards Reinsurance
	4. Claims Management
	5. Customer Outcomes
	6. Reserving
SOLVENCY	7. Capital
	8. Investment
	9. Liquidity
OPERATIONAL	10. Governance, Risk Management and Reporting
	11. Regulatory and Financial Crime
	12. Operational resilience
	13. Culture

One consistent approach to syndicate and agent categorisation based on assessment against Principles on a qualitative and quantitative basis



Growth and development opportunities for the best run businesses

An escalating scale of interventions that are linked to principles and overall syndicates categorisation

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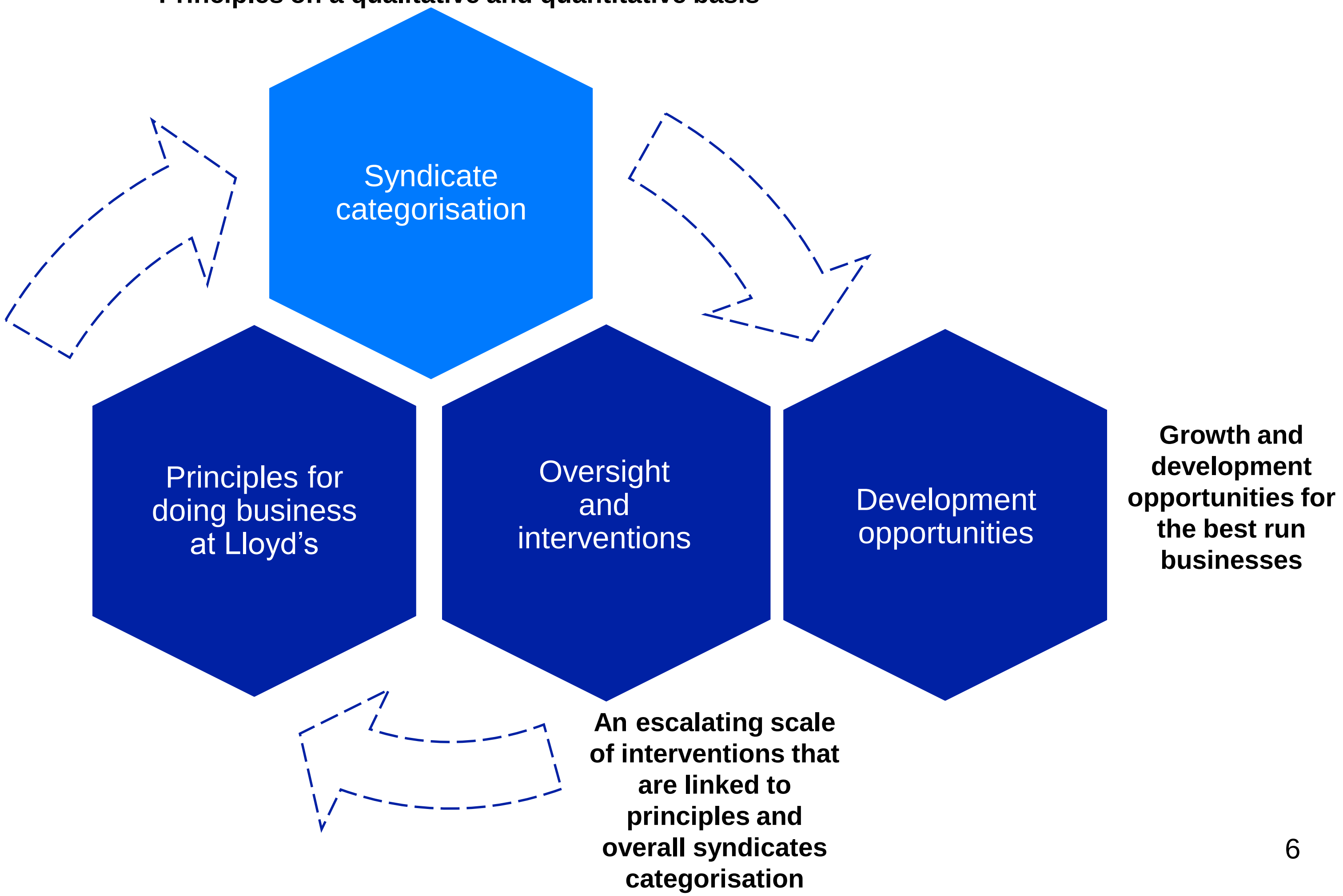

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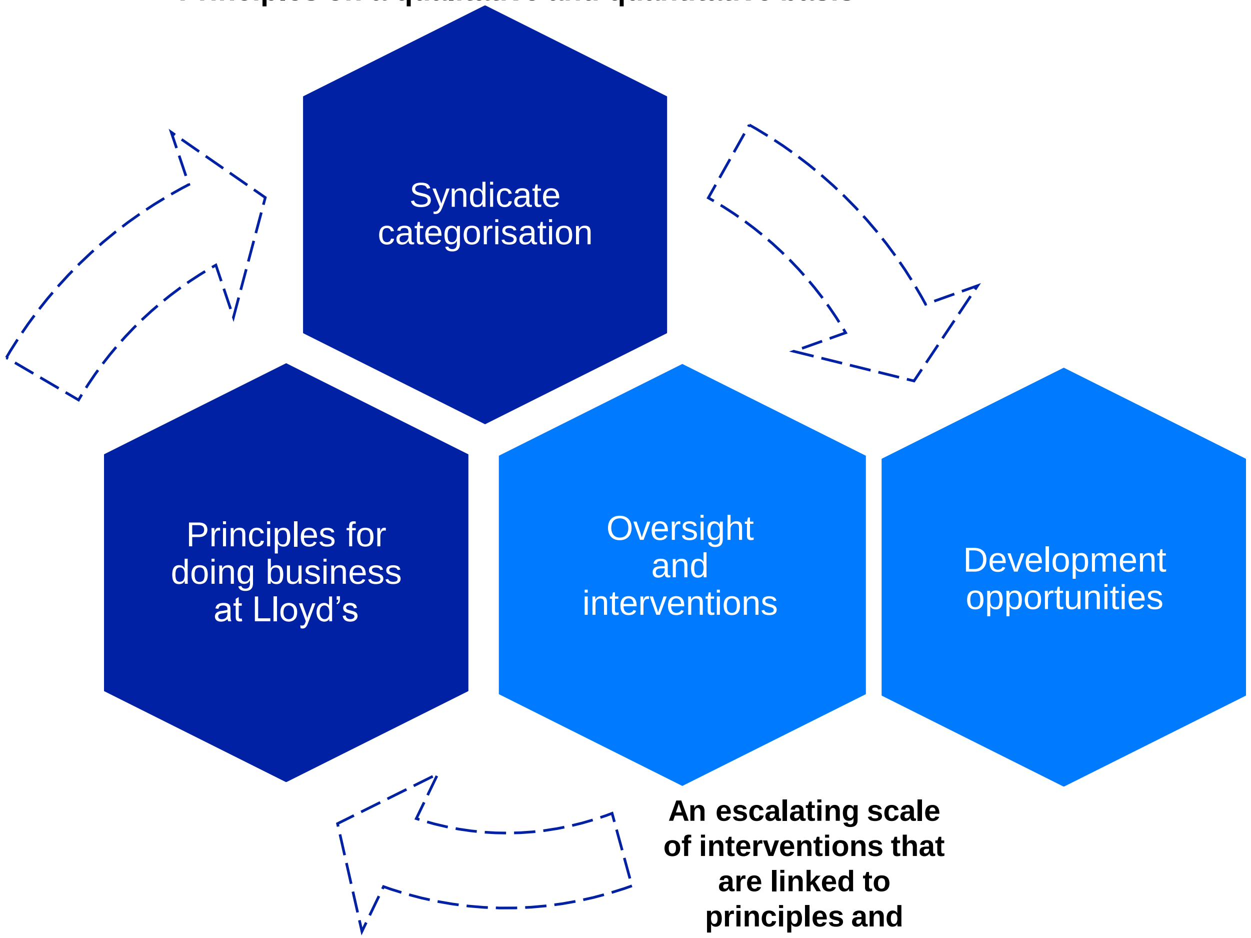


Growth and development opportunities for the best run businesses

An escalating scale of interventions that are linked to principles and overall syndicates categorisation

Oversight Framework

How do we categorise syndicates?

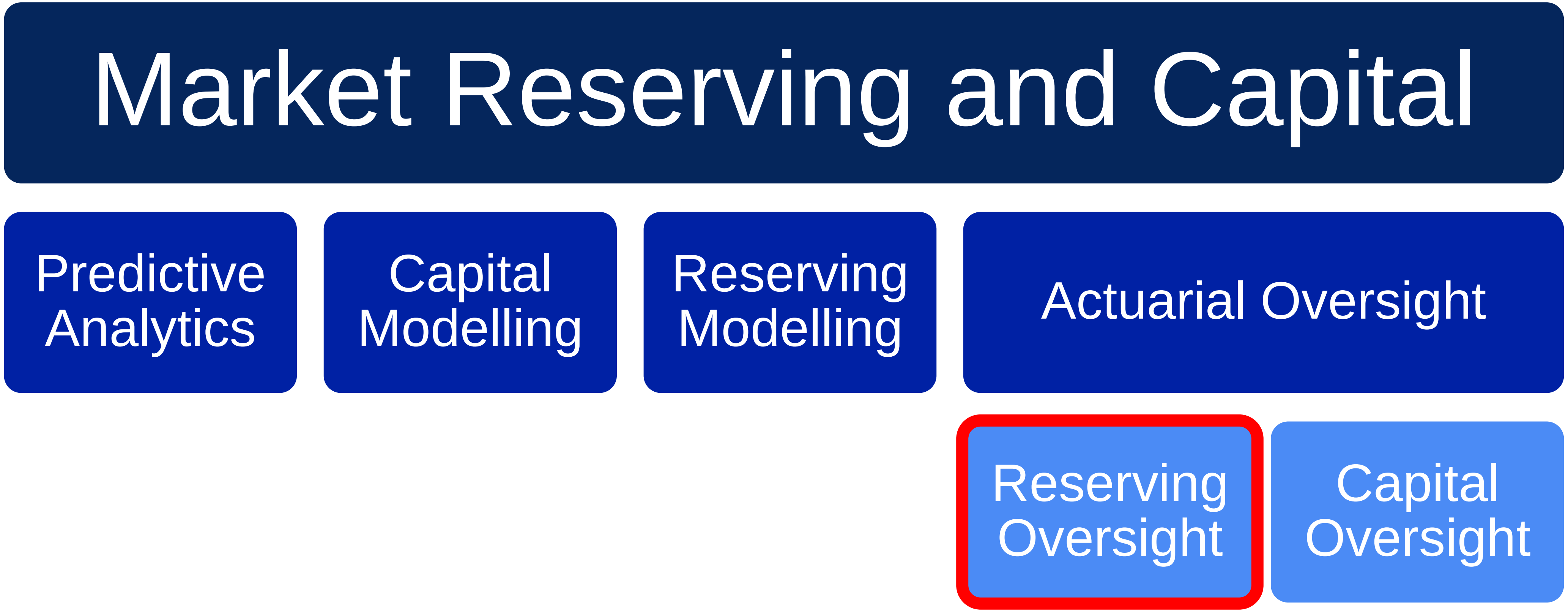
Dimension Rating
Meets expectation
Marginally below expectation
Below expectation
Well below expectation

Oversight Dimensions		Expected Maturity	Actual Maturity	Dimension Rating		Syndicate Category
Performance	Underwriting Profitability	Advanced	Advanced	Meets expectations		GOOD
	Catastrophe Exposure	Established	Intermediate	Marginally below expectations		
	Outwards Reinsurance	Foundational	Foundational	Meets expectations		
	Claims Management	Foundational	Foundational	Meets expectations		
	Customer Outcomes	Foundational	Foundational	Meets expectations		
	Reserving	Advanced	Advanced	Meets expectations		
Solvency	Capital	Established	Intermediate	Marginally below expectations		
	Investments	Established	Established	Meets expectations		
	Liquidity	Foundational	Foundational	Meets expectations		
Operational	Governance, Risk Management and Reporting	Established	Established	Meets expectations		
	Regulatory and Financial Crime	Intermediate	Intermediate	Meets expectations		
	Operational Resilience	Foundational	Foundational	Meets expectations		
	Culture	Foundational	Foundational	Meets expectations		

OUTPERFORMING
GOOD
MODERATE
UNDERPERFORMING
UNACCEPTABLE

Oversight framework

Where does Reserving Oversight fit in?



Oversight Framework – Reserving

What risk are we managing?

- **Aim of the Reserving oversight team is to manage the risk of inadequate syndicate reserves.**
- **We want to minimise likelihood of future best estimate reserve deteriorations and to avoid any undue risk to Lloyd's performance and solvency position.**
- **Considered what the key bedrocks are to support robust reserving practices. This has led to the six sub-principles.**

Managing agents should ensure syndicates set reserves which are underpinned by a robust reserving process. All Actuarial Function requirements should be met in line with Solvency II.

To support this, managing agents should ensure their syndicates:

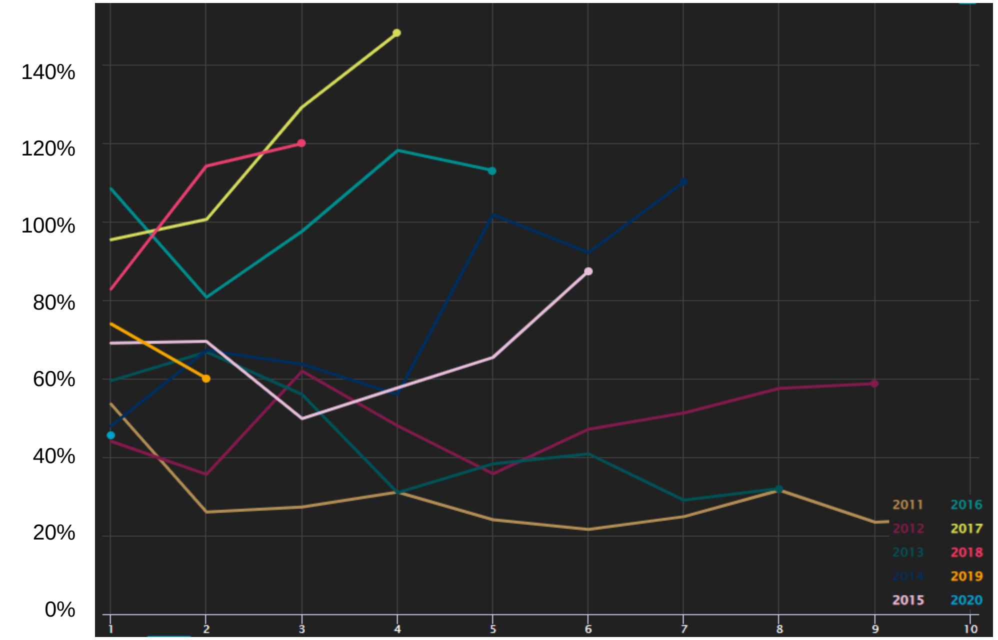
1. Have clear governance and ownership of the reserves
2. Make appropriate allowance for uncertainties when setting reserves
3. Use assumptions to set reserves which are realistic, transparent and consider historical experience
4. Identify, understand and justify any differences in assumptions between reserving and other functions
5. Periodically and objectively challenge the reserving processes and assumptions
6. Set best estimate reserves in line with Solvency II principles, with any allowance for UK GAAP margins set explicitly in addition

Oversight Framework – Reserving

How to assess performance against the Principles?

Assessment against Principles will be through combination of qualitative and quantitative measures

Quantitative example: ULR over time



- ULR has increased over time on several YOAs
- The ULR for the latest year is significantly lower than previous years

Qualitative example

2 Make appropriate allowance for uncertainties when setting reserves

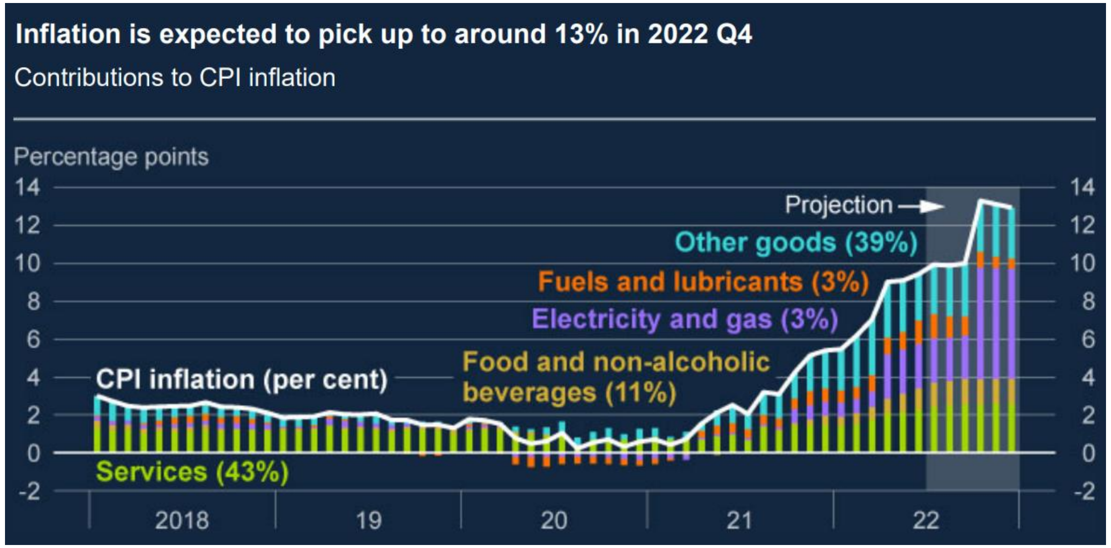
- Are the most material uncertainties and risks considered, both qualitatively and quantitively?
- Is a range of estimates produced, and how?
- What scenarios are carried out, if any? How well is the likelihood of these scenarios understood?
- How well is the shape of the reserve distribution understood?
- What information on uncertainties is presented to the Board?
- What input is gained from other functions to help determine the level of uncertainty e.g. the claims team?

Inflation Reserving

Inflation - General background

Uncertainty around economic inflation persists

Bank of England Inflation Projection



Source: Bank of England Monetary Policy Report August 2022

Institutional Projections

Goldman Sachs — 22%

- Forecast that UK inflation could hit 22% in the early months of 2023 if energy prices continue to climb.

Citi — 18%

- Forecast that UK inflation could hit 18% in the first quarter of 2023, while the retail prices index inflation rate could soar to 21%.

- A range of views above highlight the continued uncertainty on future economic inflation assumptions
- **Claims inflation does not just equal CPI, the expectation is that Syndicates consider what indices may be relevant and if adjustments are needed**
- Reserving actuaries should continue to improve their processes to assess and monitor the impact of economic inflation on their claims.

Lloyd’s definitions

How do we define claims inflation and its various elements?

Claims inflation

- Change in claims cost of a like for like policy over time
- Sum of economic inflation and excess inflation

Economic inflation

- Changes in claims costs captured through published economic indices relevant to an insurer’s mix of business

Excess inflation

- Changes in claims costs beyond what is captured in economic indices, including factors which are specific to a (re)insurers’ business and including social inflation.

Social inflation:

- Subset of excess inflation
- Claims inflation as a result of societal trends

How has Lloyd’s communicated to syndicates so far?

We have provided information through presentations, report and guidance

To help the market tackle this complex issue, Lloyd’s has shared inflation related reserving material in recent months

June

Lloyd’s NED session

This session focused on:
- Defining Claims Inflation.
- Potential approaches and considerations on quantifying the impact of inflation.

Link to slides and session recording is here

June

Reserving Guidance – Allowing for Inflation

This memo sets out Lloyd’s expectations on reserve setting for managing agents in response to the high inflationary environment and provides additional guidance.

Link to memo is here

July

LMAG – Lloyd’s Update

Discussions in this LMAG update included:

- Observations from our thematic review of inflation.
- Summary of best practice approaches
- Limitations of currently adopted approaches

August

Lloyd’s Reserving Thematic Review Report

- Provides greater detail on the findings shared in the LMAG with greater focus on recommendations for the market

Link to Report is here

What does Lloyd’s expect of syndicates?

Lloyd's has issued guidance on Reserving, Capital and Planning for inflation allowances

Reserving

Syndicates are expected to:

- Consider inflation explicitly as part of the best estimate reserving by class of business and geography
- Be able to clearly explain how inflation has been allowed for to allow challenge from various stakeholders
- Take a considered and balanced approach to allow for inflation which reflects the specificities of your risk profile

Capital

Syndicates are expected to:

- Reflect the current economic conditions in their capital models
- If used, ensure that the economic scenario generator (ESG) is appropriate and validate the outputs
- Perform sensitivity testing on inflation volatility
- Conduct Stress and Scenario tests related to the heightened economic inflation and potential for recession

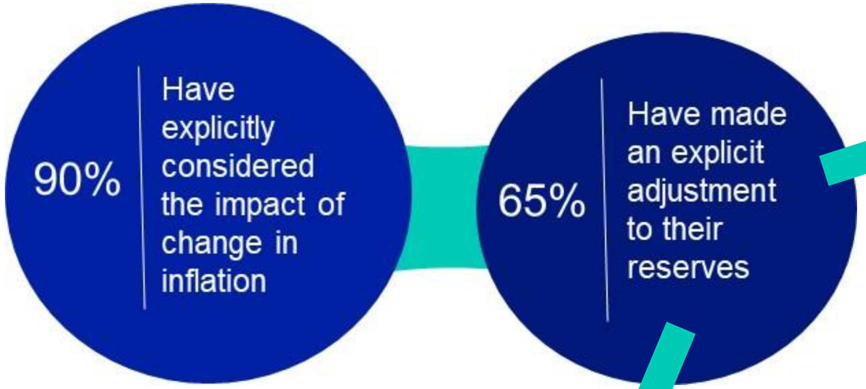
Planning

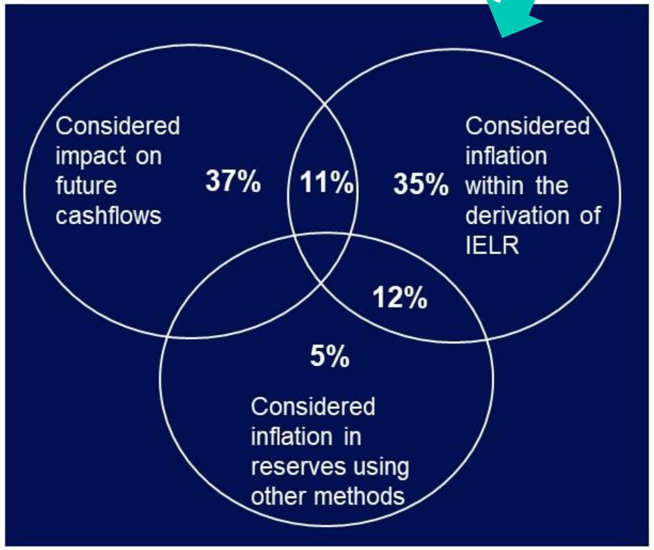
Syndicates are expected to:

- Consider claims inflation explicitly as part of business planning by class of business
- Report on how inflation assumptions have been made
- Understand inflation captured within exposure changes versus other inflationary pressures that may be need to be priced for

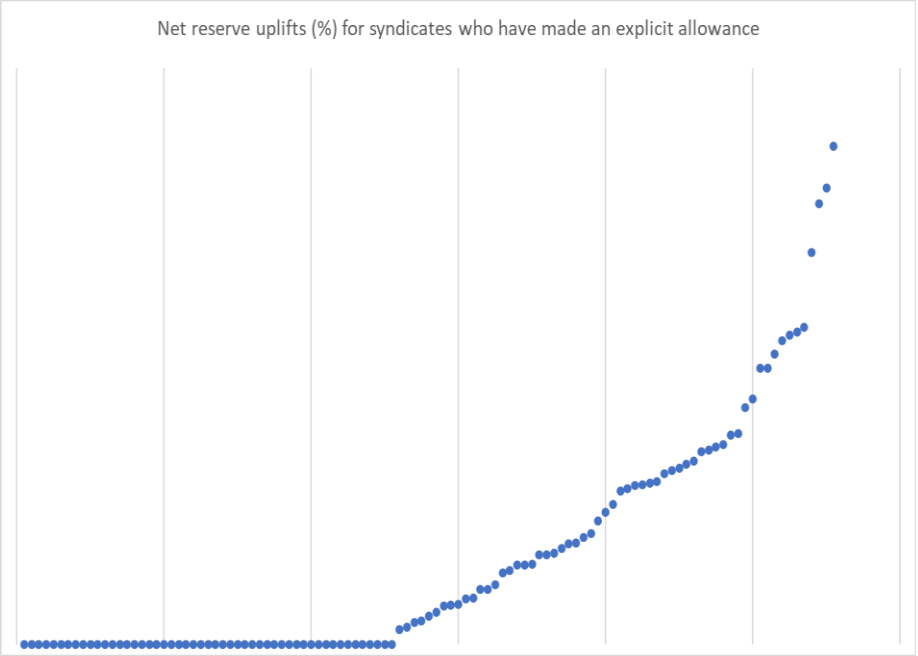
What were our findings from our Q2 review?

Steps in the right direction as at 2022HY





Net reserve uplifts (%) for syndicates who have made an explicit allowance



- The was an overall uplift to net reserves as at Q2 2022 of 2.3%.
- The appropriateness of the allowance depends on the risk profile of the syndicates

What could a good approach look like?

Example of a cashflow based approach

Use payment patterns to derive expected cashflows

Two inflation indices derived: base index and heightened index

Excess factor derived and applied to expected cashflows to estimate uplift

At COB level and by collaborating with the wider business

Future Year	1	2	3	Total
Unadjusted reserve (£m)	50	30	20	100
Base inflation assumed	2%	2%	2%	
Revised inflation forecast	10%	5%	2%	
Base index	1.02	1.04	1.06	
Revised index	1.10	1.16	1.18	
Excess factor	**1.08**	**1.11**	**1.11**	
Adjusted reserve (£m)	54	33	22	109
Adjustment for additional inflation (£m)	4	3	2	9

Inflation assumed implicitly in claims triangle

From ground up claims inflation

Cashflow uplift factors

Social Inflation

How did we conduct our Thematic Review?

Detailed Review

12 syndicates

Social inflation **detailed** questionnaire

One hour meeting covering social **AND** economic inflation

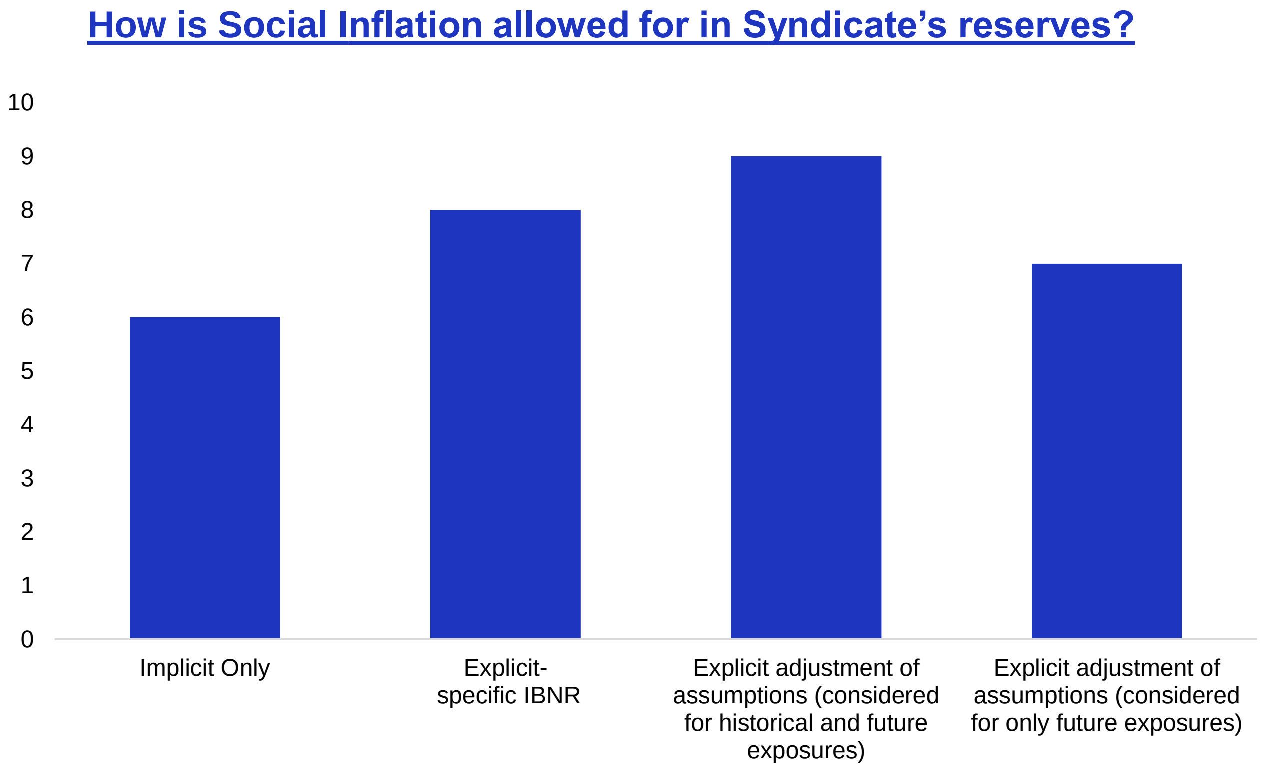
Voluntary Submissions

13 syndicates

Social inflation **lighter** questionnaire

Social Inflation

The majority of syndicates made explicit adjustments for social inflation



1) More than half allow for social inflation explicitly

2) Most common was allowance through IELR

3) Additionally, some added specific IBNRs relating to particular issues, e.g. #MeToo

4) Examples of implicit considerations were:
   - Favourable experience held back
   - Case reserves frequently updated
   - Reserving assumptions were set with awareness of social inflation

Social Inflation

Risk management and mitigation approaches

1) **Specific RI programmes purchased to protect classes materially exposed to social inflation, e.g. Stop loss**

2) **Enhanced feedback loops**
   - Detailed emerging risks reports from Claims
   - Watchlists improved and the focus of conversations

3) **Claim teams more focussed on settling claims exposed to social inflation early**

4) **Re-underwriting**
   - Reducing exposures to particular geographies
   - Exiting classes altogether

Social Inflation

Other findings

1) **Most classes identified as materially exposed to social inflation were as expected**
    - But some uncommon classes identified, e.g. Energy Offshore Liability where social inflation is considered with respect to climate change litigation

2) **Aside from the US, geographies that were mentioned the most were Australia and New Zealand**
    - Potential early signs of impact in other regions too such as Europe

Major Loss Update

Ukraine Crisis: High level messages

Expected to be a major but manageable event

- We expect this to be a major but financially manageable event for the market in 2022
- Not a solvency or capital event for corporation or individual syndicates
- Aviation, Marine, Political Risk, Political Violence and Trade Credit classes are impacted
- Consequences for insurance market fluid and complex
- Operational challenges and economic uncertainty will persist

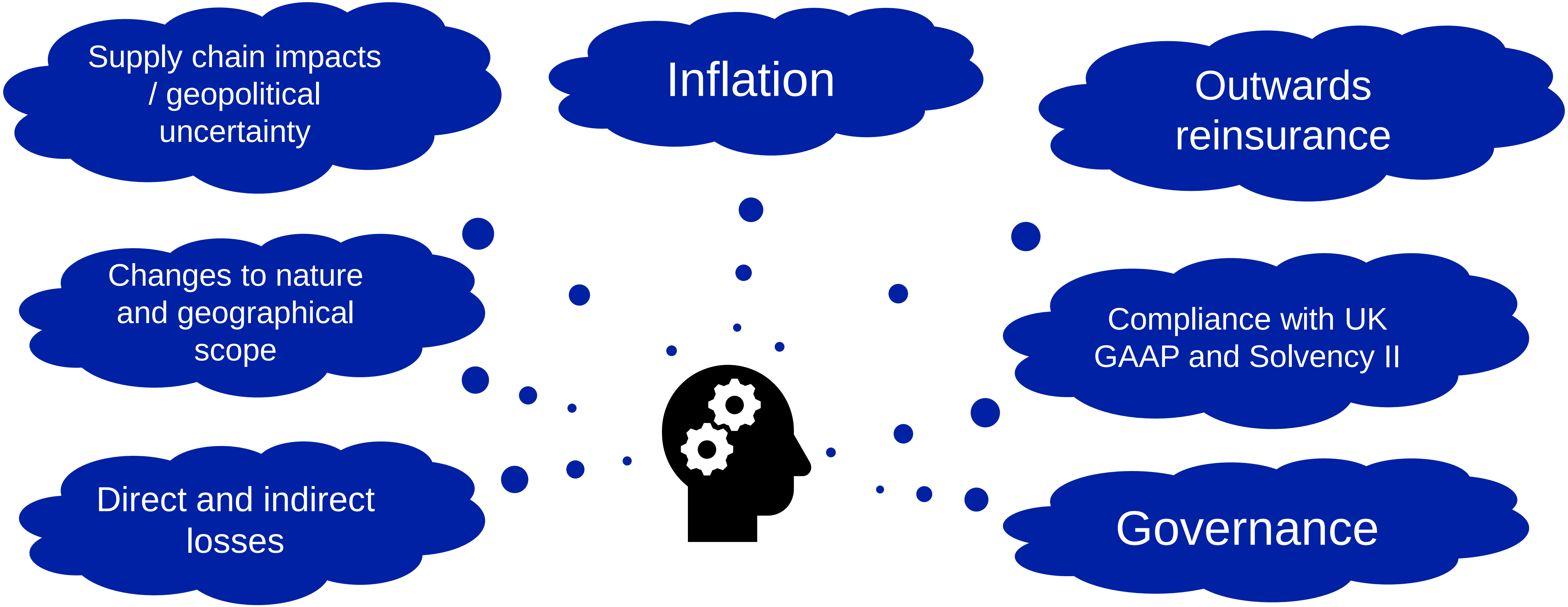
Ukraine Crisis: Uncertainties

Significant and prolonged uncertainties remain

Class level uncertainty	**Ongoing nature of crisis:**	The duration, severity and geographical impact of the crisis is unknown and highly uncertain. In particular, it is very difficult to estimate potential losses in respect of the conflict extending into new territories and the extent of losses which could emerge the longer the crisis runs.
	Evolving sanctions:	New sanctions continue to be introduced and whilst not expected soon, the timing of any future removal of sanctions difficult to predict. Uncertainty around impact of disruption to provision of services from Russia and Ukraine.
	Lack of notifications:	Reserves are largely IBNR at this point with few loss notifications
	Coverage:	Coverage for Aviation and potential for lengthy litigation
	Asset values:	Exact value of planes in the impacted regions is challenging to estimate. Ships written off after 12 months.
Other uncertainties	**Reinsurance:**	Risk of dispute over coverage terms. Risk of erosion due to impacts from classes on same treaty. Heightened default risk due to exposure to several counterparties.
	Data:	Lots of information outstanding at this stage, will take time to receive and develop clear picture, e.g. loss notifications, loss adjustment reports, up to date satellite and drone imagery, on-the ground reports, information about exposure.
	Economic uncertainties:	Indirect losses from macroeconomic pressures and disruption to global trade and financial markets

Ukraine Crisis: Considerations for Reserving

We have set out some key areas we think should be considered for Ukraine reserving



COVID-19: Considerations for Reserving

What did reserving actuaries have to consider at the start of the pandemic?

Contract wording and BI test cases

Recessionary impacts e.g.
- More litigious environment
- Less money spent on general maintenance
- Impact of WFH
- Potential COVID angst

Operational impacts

Ability to reschedule, rather than cancel, events

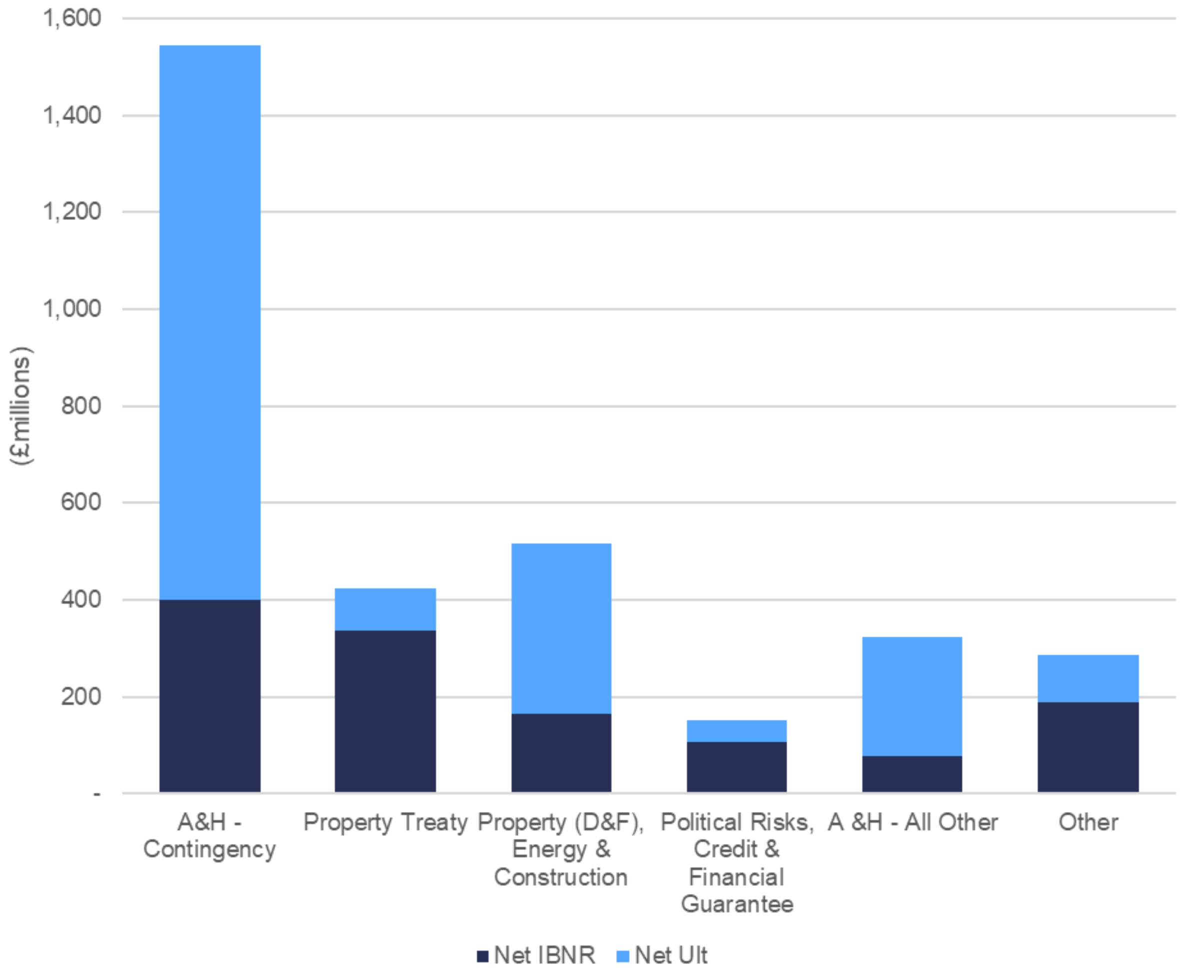
Mitigation e.g. motor

Length of economic disruption

Outwards reinsurance

Covid-19 Net IBNR by Class

IBNR percentage held varies significantly by class

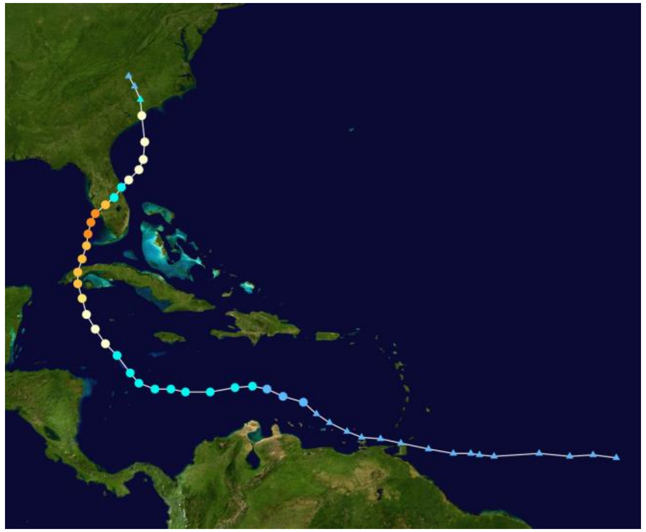


- Whilst the majority of COVID-19 IBNR is held in Contingency, as a class this is relatively developed.
- Property Treaty and Political Risks, Credit & Financial Guarantee classes are both material and offer a large proportion of IBNR as a class.
- Syndicates are holding significant IBNR for the following reasons:
  - ➢ Court Rulings / Test Cases
  - ➢ Long Tail on Reporting
  - ➢ Slow Inwards RI Development
  - ➢ Other - such as specific future events without exclusions clauses (e.g. Olympics), indirect impacts, uncertainty around RI recoveries, and some prudence.

Hurricane Ian: What we know so far

Expected to be a major natural catastrophe loss

- Broad range of estimates on size of industry loss
- Extreme flood damage from storm surge
- Multiple locations and multiple classes impacted



- Exposure to the current inflationary environment will push up losses and uncertainty
- Litigation forms a significant component of some vendor loss estimates

Looking ahead