OUR SOLUTIONS

Project Rio: Lloyd's transition to principles-based supervision

February 2022

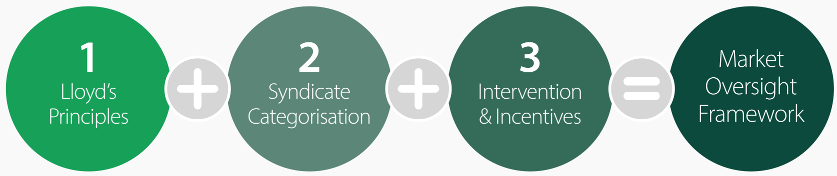
Fundamental changes to regulation within the Lloyd's market are quietly drawing closer. Lloyd's soft launched its Oversight Framework at the beginning of 2022, heralding a new era of principles-based supervision.

The first milestone is an ask of firms to develop their own self-assessment in early Q2, determining how they rate themselves against the new principles.

The changes Lloyd's has made are intended to create a more efficient and joined-up approach that fosters the right conditions for the best businesses to thrive. However, the carrot also comes with a stick. Here, it takes the form of a more decisive and impactful interventionist approach for firms that are seen to be underperforming, based on objective, data-driven assessments. Importantly, the new principles expand Lloyd's purview into areas such as culture, operational resilience and management reporting.

There's a lot at stake. At the highest level, Lloyd's will split firms into two broad categories – the first of these being those doing well, and which will be incentivised within the Lloyd's market, enjoying the opportunity to grow. Conversely, the second group, those seen as not performing well enough, are likely to experience heightened oversight and intervention from Lloyd's, which could include a number of measures designed to reduce risk and improve performance, but which will not be easy medicine to swallow.

The new framework has three interlinking elements, that work together and are intended to support more differentiated and impactful oversight of firms:



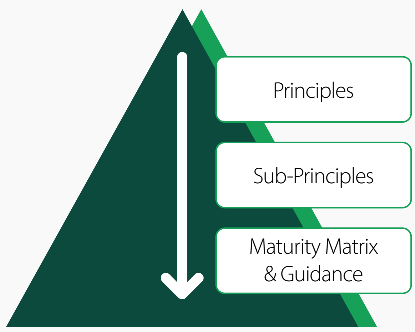
Source: Principles for doing business at Lloyd's

PRINCIPLES-BASED APPROACH

The new suite of 13 Principles will be supported by sub-principles and guidance, including a Maturity Matrix against which firms are expected to self-assess (of note, Lloyd's will also be making its own assessment of firms – more on that below).

The 13 principles are grouped into three categories; which are Performance, Solvency and Operational.

We have shown below and right the narrative supporting each principle, but the 13 principles also each have one or more sub-principles, that support the assessment of a firm's performance.



Source: Principles for doing business at Lloyd's

THE 13 PRINCIPLES FOR DOING BUSINESS AT LLOYD'S

PERFORMANCE	1	Underwriting probability	Managing agents should produce and execute syndicate business plans which are logical, realistic and achievable and ensure the delivery of a sustainable profit, including expense management.
	2	Catastrophe exposure	Managing agents should ensure syndicates maintain appropriate control of catastrophe risk (from natural and non-natural perils) in line with business strategy.
	3	Outward reinsurance	Managing agents should define and execute syndicate outwards reinsurance strategy and purchasing plans which effectively support the wider syndicate business strategy and objectives.
	4	Claims management	Managing agents should ensure that they have a claims commitment in place designed to deliver a high-quality claims service which includes a prompt and fair customer service, efficient and effective claims handling, and compliance with legal and regulatory obligations.
	5	Customer outcomes	Managing agents should embed a culture and associated behaviours throughout their business to ensure that they consistently focus on good customer outcomes and that products provide fair value.
	6	Reserving	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.

SOLVENCY	7	Capital	Managing agents should ensure syndicates Solvency Capital Requirement (SCR) appropriately reflects their risk profile and is calculated using a SII compliant internal model.
	8	Investment	Managing agents should ensure syndicate investment risk is effectively controlled, informed by wider business strategy and adheres to the Prudent Person Principle (PPP) requirements.
	9	Liquidity	Managing agents should ensure syndicates have contractual access to sufficient liquidity in order to withstand a severe liquidity event (defined by Lloyd's), underpinned by a robust liquidity risk management framework.

OPERATIONAL	10	Governance, risk management and reporting	Managing agents should have governance structures and internal risk management and control frameworks in place which align to Solvency II requirements, enable sound and prudent management of the business and support delivery of the business strategy.
	11	Regulatory and financial crime	Managing agents should have robust frameworks in place to assess and address regulatory and financial crime risks arising from UK and international businesses. Frameworks should support compliance with law, regulation/guidance, and allow for well informed, transparent relationships with Lloyd's and applicable regulators.
	12	Operational resilience	Managing agents should maintain robust and resilient operations, embedding cyber resilience and effective third-party risk management.
	13	Culture	Managing agents should be diverse, creating an inclusive and high-performance culture.

Source: Principles for doing business at Lloyd's

HOW WILL FIRMS BE ASSESSED?

Firms will assess the extent that they meet the principles - and their various sub-principles - using a four-point maturity matrix. The maturity matrix sets out indicators and examples of different ways that the Principles and sub-principles could be achieved across differing materiality levels. The guidance is expressed in terms of outcomes, capabilities and processes but is not exhaustive nor prescriptive.

Foundational (Low Materiality)	**Intermediate** (Moderate Materiality)	**Established** (High Materiality)	**Advanced** (Highest Materiality)
Syndicate with foundational capabilities. Core competencies and processes in place to effectively manage lower materiality risk exposure	Syndicate with intermediate capabilities. Consistent with good market practice observed at Lloyd's, demonstrating comprehensive, well embedded processes to effectively manage moderate materiality risk exposure	Syndicate with established capabilities. Consistent with strong practice observed at Lloyd's and globally, demonstrating sophisticated processes and strong capabilities to effectively manage high materiality risk exposure	Syndicate with advanced capabilities. Consistent with Lloyd's and global best practice, showing leadership on emerging techniques, and proactively supporting Lloyd's in improving standards across the market

Source: Principles for doing business at Lloyd's

In general, the more 'material' a syndicate is, the more sophisticated Lloyd's would expect the Managing Agent's capability to be. Lloyd's believes that moving away from prescriptive, rules-based oversight to a more outcomes-based approach will require firms to adopt a different mindset.

Certainly the move from relative certainty to subjectivity is likely to raise challenges for all - but could also present a real opportunity to look at things differently.

Firms will be assessed using the Maturity Matrix, and get a summary assessment against each of the three assessment categories, with four possible outcomes. They could meet expectations, be marginally below expectations, below expectations - or well below expectations.

In turn these will lead to an overall assessment for a firm, which could be one of the following five ratings:

Outperforming
Reduced oversight, by exception

Good
Monitoring

Moderate
Targeted oversight, intervention

Underperforming
Robust intervention and rapid remediation

Unacceptable
Immediate action, possibly including run-off or requirement for syndicate to appoint a new MA

Of note, in the hypothetical example Lloyd's presented in training for boards, a firm with eight 'meets expectations', two 'marginally below' and three 'below' ratings against the 13 principles achieved an overall outcome of 'underperforming'. This is just one example, and we do not know whether Lloyd's will weigh any of the principles more heavily than others, but it indicates that lower ratings and greater intervention will be a realistic prospect for firms that do not have all of the principles under control.

Senior managers and board members should be asking themselves what they need to do to prepare, and whether pivoting to a maturity based, principles-based approach could present an opportunity to improve practice in a range of areas. This is no longer a binary 'yes or no' response to whether they met Lloyd's minimum standards, but a nuanced and evidenced conversation. One thing is for certain, the relationship with Lloyd's will be more important than ever for Managing Agents.

Firms will be expected to develop an initial 'best-efforts' assessment at the start of Q2 – and while the results do not need formal board approval, Lloyd's expects that the Boards of Managing Agents will have at least reviewed the results.

Using insights and data already available to them, Lloyd's will also look to perform their own assessment of firms against the principles. They have said this assessment will be as non-intrusive as possible. Clearly, where there is disagreement between a firm's view and Lloyd's view there will need to be a reconciliation process to determine both Lloyd's overall supervisory stance - and the nature of any remedial actions required.

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WHAT CAN MANAGING AGENTS DO TO PREPARE THEMSELVES?

There are key questions firms should consider, as they get ready for the new principles:

What does the move to principles-based oversight/ outcomes-based thinking really mean for us?

What changes to we need to make (from the top down and bottom up) to increase our maturity across all of the principles?

What is our target state of maturity?

Are our business processes and controls really setting us up for success in achieving the right business outcomes – and how can we move the needle?

The starting point is an objective self-assessment of a firm's current state.

The results of the assessment can be used to prioritise identified gaps for remediation, and to determine needed actions, resources and timelines. In practice, the 13 principles are diverse, and will require a wide range of subject matter expertise, both to conduct an accurate and objective assessment of the current state, and to develop and implement pragmatic and appropriate remediation, where needed.

Overall, firms should set a target state of maturity that is right for them considering the materiality lens, and ensure they work to close gaps , with agreed timelines for remediation. The results will form the majority of the content of the self-assessment document submitted to Lloyd's. The greater the objectivity of the assessment, the easier it will be to reconcile differences with Lloyd's own assessment down the line.

What happens next?

Lloyd's are working with firms to deliver board training aimed at promoting understanding of the new requirements. As part of the 'soft launch' of the new framework, firms are not required to submit the usual minimum standard attestation in 2022. However, Lloyd's are requesting a 'best efforts' self-assessment from managing agents against the new Principles by 29 April 2022.

Self-Assessment Process – Managing Agent/ Syndicate Level:

- Managing Agents will be required to record a view of their assessed maturity against the overall Principle (on a best-efforts basis) as well as the Sub-Principles, and the assessments should be supported by appropriate rationale – by 29 April 2022.
- Where the self-assessment has concluded that the expected maturity has not been met, the commentary should include narrative setting out the planned remediation and appropriate timescales.

Self-Assessment Process – Lloyd's Review

- During the early part of 2022 Lloyd's oversight teams will conduct their own assessments of syndicates and Managing Agents against the new Principles based on their current knowledge and utilising any existing documentation where possible.
- Where there are significant gaps in oversight teams visibility for a syndicate or managing agent additional documentation may be requested but this will be by exception.
- During this time, Lloyd's will share their assessments of Managing Agents/Syndicates for feedback and discussion.

How Sicsic Advisory can help

Sicsic Advisory is made up of senior insurance practitioners with decades of operational and advisory experience in all of the areas addressed by the new principles.

Our services include:

- ***Self-assessment return***
  Helping managing agents navigate their first reports.
- ***Maturity assessment***
  Assessing against the new principles to give comfort that firms' own assessments are objective and accurate prior to submission.
- ***Embedding an outcomes-based mindset***
  Process reviews, training and support for your teams to support the transition.
- ***Technical assessments***
  We have expertise in all 13 of the technical areas covered by the principles and can assist firms during what is a reasonably accelerated assessment timeline.
- ***Remediation***
  We can help firms to develop appropriate and pragmatic remediation actions that will address any gaps identified, either through their own self-assessment or by Lloyd's. This will include how to effectively communicate progress.

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