

# A New Approach to Third Party Oversight

Consultation Document  
January 2019

# 1 Consultation

1. Lloyd's is proposing to make changes to its requirements and processes for delegated underwriting and delegated claims handling. These changes are designed to modernise our arrangements, support reduced compliance costs and support a new risk-based approach to oversight. We believe these changes will make our prudential oversight of the market more robust and will drive better policyholder outcomes.
2. The changes will involve making amendments to the Intermediaries Byelaw, the Requirements made under the Intermediaries Byelaw<sup>1</sup> and to the 'Code of Practice - Delegated Authority'<sup>2</sup>. These changes will also be supported by a new integrated online system to replace the current ATLAS and BAR systems.
3. Before making the changes, Lloyd's is consulting on its proposed new approach and on the corresponding required changes to the Intermediaries Byelaw and the associated Requirements. The byelaw changes will provide the framework provisions we need to put in place and, in due course, we will publish the more detailed rule changes that will more fully implement the proposals set out here. You can find details on how to respond to the consultation by visiting [www.lloyds.com/a-new-approach-to-third-party-oversight](http://www.lloyds.com/a-new-approach-to-third-party-oversight). Lloyd's will also be actively engaging with the market, including relevant market associations, to obtain feedback.
4. In summary, we are proposing to make the following changes –
  - a. Lloyd's will embed a risk-based approach to delegated authority approval and oversight, meaning that it will focus its resources on higher risk arrangements and will place more reliance on managing agents' own judgments where Lloyd's assesses the risk as lower. Our risk-based approach will have regard to the risk profile of the firm in question, the products it deals with and also the capabilities of the relevant lead managing agent. Approvals for more straightforward applications including certain changes to permissions will in some cases be automated to be dealt with on the new system without the need for a member of the Delegated Authority Team becoming involved.
  - b. The new approval and ongoing oversight process will be supported by an LM TOM funded replacement to the ATLAS and BAR system to be known as Chorus. It will also have a binding authority contract builder functionality to make it easier to achieve placements with 'right first time' binding authorities.
  - c. We propose to bring claims third party administrators (TPAs) into the scope of Lloyd's oversight so that they will require Lloyd's prior approval before appointment and they will be subject to Lloyd's ongoing oversight consistent with the arrangements already in place for coverholders. TPAs are a key part of Lloyd's service network but at present are assessed individually by managing agents, each of which will have their own, different due diligence criteria. There is therefore a lack of consistency of approach to TPAs and the quality of the due diligence is

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<sup>1</sup> All byelaws referred to in this Consultation Document and any requirements made pursuant to those byelaws can be viewed at [www.lloyds.com/actsandbyelaws](http://www.lloyds.com/actsandbyelaws).

<sup>2</sup> Available at [www.lloyds.com/coverholders](http://www.lloyds.com/coverholders)

variable. We believe TPAs would benefit from the centralised oversight already in place for coverholders, which will offer TPAs and managing agents a single, best practice approach. Once approved these TPAs will be able to use the Lloyds brand and refer to themselves as a 'Lloyd's Approved Claims Administrator.'

- d. We are proposing to introduce into our rules a new category of firm that can have delegated authority to underwrite or determine claims on behalf of underwriters without first obtaining prior Lloyd's approval to be a coverholder or TPA. Before delegated authority can be given, however, the firm will need to satisfy certain criteria prescribed by Lloyd's or otherwise obtain express agreement from Lloyd's to the delegated authority. Creating this new category will give Lloyd's flexibility that it presently lacks to allow certain types of arrangement for delegating underwriting or claims handling that do not fit well within our current coverholder approval regime. In particular, we believe introducing this new category is important as it is clear that our present requirements do not work well for products sold via the internet by firms operating automated online systems where the use of such systems can reduce operational risk and do not merit being subject to the full approval process. Our current requirements also do not work for high volume products being sold by firms – 'distributors' – that have a fixed or system generated price and terms and which do not involve any individual risk underwriting. These products are often sold to consumers alongside other retail purchases. Subject to managing agents having appropriate controls in place, which we are prescribing, we believe that the firms selling these products should not be required to go through the full coverholder approval process.
  - e. We are updating our rules to remove the strict prohibition currently in place for sub-delegation. We continue to view sub-delegation as undesirable in most cases but it is clear that there are times where sub-delegation should be allowed, if appropriately controlled. This particularly can be the case where coverholders wish to distribute products through 'distributors' or online portals, which can involve a limited element of sub-delegation. At present there is no flexibility in our requirements to allow sub-delegation regardless of the risks posed. We propose to change our rules to allow Lloyd's greater discretion. All forms of sub-delegation will, however, still be subject to strict requirements, which we will prescribe; sub-delegation will still only to be permitted in restricted cases or will need to be agreed with Lloyd's on a case by case basis.
  - f. A number of other more limited changes are proposed to the Intermediaries Byelaw and the Requirements made pursuant to that Byelaw, which are summarised at the end of this document.
5. We believe that the package of measures in this Consultation Document will not only support good oversight but they are also integral to supporting the 'ease of doing business' objective for delegated authority business at Lloyd's.
  6. The detailed proposals are explained in the next sections. We are also making available the byelaw amendments we intend to make and the related amendments to the Requirements made pursuant to the Intermediaries Byelaw - these will allow us to deliver the changes. We will, in due course, publish the more detailed changes to the 'Code of

Practice – Delegated Authority’ which will implement a number of the changes discussed in this document.

7. This Consultation Document contains a number of specific queries upon which we are inviting comment. However, consultees are welcome to provide comments generally on these proposals.
8. This Consultation Document is being made available to all managing agents, the Lloyd’s Market Association, all members’ agents, the Association of Lloyd’s Members, the Wholesale Speciality Insurance Association, the Managing General Agents’ Association and to the London and International Insurance Brokers’ Association, as well as to existing coverholders and TPAs.
9. Details of how to respond to the consultation can be found by visiting our webpage at [www.lloyds.com/a-new-approach-to-third-party-oversight](http://www.lloyds.com/a-new-approach-to-third-party-oversight) where a copy of this document and other supporting materials, including details of our proposed byelaw and requirement changes, can be downloaded. **All responses must be received by 15 April 2019.** If you have any questions or would like more information, you can contact [coverholders@lloyds.com](mailto:coverholders@lloyds.com).

## 2 Background and context to our proposals

10. The Lloyd’s market currently underwrites around £9 billion of premium each year through its network of delegated underwriting arrangements. This represents around 30% of the market’s business.
11. At Lloyd’s, the principal way of giving delegated underwriting authority is by appointing firms known at Lloyd’s as ‘coverholders’<sup>3</sup>. They are authorised to enter into (i.e. ‘bind’) contracts of insurance with policyholders in accordance with the authority given to them by the syndicate on whose behalf they are underwriting. The coverholder’s authority will be set out in contracts of delegation which are known as ‘binding authority agreements’.
12. Typically, coverholders write relatively high volume, low individual premium business which is predominately consumer and SME business, although some coverholders do write commercial risks or reinsurance. Currently, Lloyd’s has around 4,300 coverholder offices worldwide (including service company coverholders) operating under more than 5,100 binding authority agreements. There has been a significant rise in the number of coverholders and the premium income they write over the past decade.
13. Coverholders themselves vary enormously in terms of size, complexity and operational capability. There have also been very significant changes in the operational and distribution methods that coverholders employ. The rise in the use of technology has, in particular, revolutionised many aspects of the way coverholders can now do business in a

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<sup>3</sup> Delegated authority can also be given to other managing agents pursuant to consortium agreements and line slips. Paragraph 1 of the Intermediaries Byelaw also provides for other limited cases of permitted delegated underwriting authority. However, presently, largely the only form of delegated authority to third party firms at Lloyd’s are coverholder arrangements.

way that could not have been imagined even 15 years ago when the current framework for delegated underwriting oversight was adopted by Lloyd's. This includes the automation of underwriting and the mass selling of insurance products via the internet.

14. When operated well, the coverholder model can be an efficient method of accessing business that would otherwise be uneconomic or impractical for a syndicate to write direct through its managing agent. Coverholders allow the Lloyd's market to provide insurance solutions and services to policyholders who would not otherwise have access to the market. Coverholders therefore remain a highly valued and core part of Lloyd's distribution strategy.
15. In addition to coverholders, the market is supported by a network of firms with claims authority. These are normally referred to as 'third party administrators' or 'TPAs'. The Lloyd's market uses the services of around 500 TPAs worldwide. In addition, many coverholders will have some level of claims authority. As with coverholders, TPAs will typically deal with consumers or SME claims and they will often work closely with individual coverholders to service claims on their binding authority agreements.
16. Together, the coverholder and TPA community represent key outsourcing partners that support the market. In this role, they play a valuable role as the face of the Lloyd's market to many of our consumer and SME policyholders, representing and promoting the Lloyd's brand worldwide.
17. Lloyd's has long recognised, however, that if not properly managed, the delegation of underwriting and claims authority to third party coverholders and TPAs can bring with it additional risks to Lloyd's, policyholders and the syndicates that operate in the Lloyd's market. The occasions when coverholders or TPAs have caused the market serious issues are, it should be acknowledged, relatively rare but history has shown that failure to manage the risk can be costly and time-consuming to resolve and policyholders can be impacted. And managing the risk is not only about avoiding things going wrong. On the positive side, by identifying the risks that can arise and educating managing agents, coverholders and TPAs about these risks there is also an opportunity to promote a culture that continuously looks to raise standards and adopt best practice.

## **Risks to be managed**

### **Conduct Risk**

In the UK/EEA alone the Lloyd's market currently has approximately 15 million consumer and SME customers most of whom will have bought their policies through coverholders and many of whom will have their claims handled by a TPA. The interaction that the customer has is with the coverholder or TPA and accordingly Lloyd's needs to be confident they have the right conduct risk controls in place.

### **Credit Risk**

Almost all coverholders will handle premium as agents for Lloyd's underwriters. The binding authority agreement will set out the basis on which that premium is held and

how quickly the coverholder must remit the premium to underwriters. TPAs will typically hold loss funds on behalf of Lloyd's underwriters. Accordingly, Lloyd's underwriters may face a credit risk in the event of default.

### **Underwriting Risk**

The majority of Lloyd's coverholders have some level of delegated underwriting discretion and 26% have full underwriting authority. Underwriters therefore need to have confidence in the quality of the underwriting decisions of the coverholder; poor underwriting can result in syndicates making significant losses. In more severe cases, underwriters are also exposed to the risk that a coverholder may write business outside the terms of its authority either deliberately or because of a lack of proper controls.

### **Reputational and Regulatory Risk**

Coverholders in particular hold the Lloyd's 'brand' and coverholders whose conduct does not meet the standards expected of someone representing the Lloyd's market can impact Lloyd's reputation. Improper behaviour on the part of a coverholder or TPA may also have an adverse impact on Lloyd's licensing arrangements.

## **Current Lloyd's Controls**

18. Given the risk profiles of these entities, Lloyd's Performance Management Directorate (PMD) has for many years overseen and supervised the coverholder distribution network and more recently it has put in place oversight controls for TPAs. These controls are primarily as set out in the Intermediaries Byelaw, the Requirements made pursuant to the Intermediaries Byelaw (which sets out some of the more detailed rules) and the 'Code of Practice - Delegated Authority'. Lloyd's has also prescribed a number of minimum standards that are particular to delegated authority arrangements<sup>4</sup>.

## **Coverholder controls**

19. The current principal controls for coverholders include –
- approval of all new coverholders
  - setting (and agreeing changes to) the permissions that a coverholder has to underwrite on behalf of syndicates at Lloyd's (e.g. by reference to the classes that a coverholder can underwrite or the territories in which they can bind risks)
  - an annual compliance check (Ongoing Coverholder Oversight)
  - maintaining a register of binding authorities
  - setting minimum standards for managing agents to meet for delegated authority arrangements

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<sup>4</sup> All Minimum Standards can be found at [www.lloyds.com/minimumstandards](http://www.lloyds.com/minimumstandards).

Where Lloyd's sees coverholders falling below the standard expected of them, Lloyd's will take pro-active steps to intervene, which in the final instance can include removing a coverholder's approval. Lloyd's also expects managing agents to exercise oversight over their coverholders as set out in the Customer Minimum Standards MS9 and Lloyd's reviews managing agents for their compliance against those standards. Best practice is also promoted, for example through the promotion of model contracts of delegation and through regular training.

## TPA controls

20. TPAs do not currently require Lloyd's prior approval to be given delegated authority. However, since the introduction of Lloyd's Claims Management Minimum Standards in 2005 (incorporated into the Customer Minimum Standards MS9 with effect from 1 January 2019) managing agents have been required to carry out appropriate due diligence before appointing TPAs and since 2012 managing agents have been required to notify Lloyd's of any TPA that they intend to appoint. In 2013, Lloyd's required managing agents to also notify Lloyd's where they intended to delegate claims handling for open market business where that delegation constitutes an important outsourcing arrangement and is in respect of contracts of insurance of a particular category or class rather than for an individual claim.

## The reasons for making these proposals

21. The current controls, outlined above, have for the most part remained unchanged for a number of years (in the case of coverholders since 2003). While there have been some important enhancements including the introduction of the Minimum Standards both for delegated underwriting and claims handling, the framework in place is still much the same. The following factors drive the need for change to our oversight framework –
  - The considerable growth in delegated authority arrangements means that Lloyd's and the market need, more than ever, to ensure that the approval and oversight process focuses on the key risk areas and attributes for sustainable and well-run business. Our rules and controls need to be risk-based and more flexible so we can be better focused on the things that really matter.
  - There have been major changes in distribution techniques including the use of online technology for sales, claims, marketing and data reporting. These mitigate some risks and potentially increase other risks (such as data security). Our rules need to be better at accommodating the rapidly changing landscape both to ensure we can be flexible in allowing new distribution methods and to ensure the associated risks can be managed.
  - Managing agents have developed their internal resources and processes to oversee delegated authority arrangements. For instance, most managing agents now have dedicated first line Delegated Authority and Conduct Teams and have invested in bordereaux management systems. They have also implemented sophisticated frameworks to meet Lloyd's Minimum Standards as they relate to

delegated authority, conduct and claims and so are better at proactively managing their own business. Our current framework, however, has not evolved to recognise this change and does not support Lloyd's adopting a flexible, risk-based approach which would allow us to place greater reliance on the improved capabilities of managing agents.

- Given the importance of TPAs to the market and the common risk factors that they share, the different treatment of TPAs compared to coverholders is now difficult to justify. A central due diligence platform is currently provided through the Charles Taylor LME database, the development of which was initiated by the market. That has provided significant value, both in terms of functionality and in pushing the market towards a more common best-practice approach. Nevertheless, the fact remains that our requirements do not support a consistent risk-based approach to TPA approvals and ongoing compliance, particularly when compared to our framework for delegated underwriting.
- Regulatory expectations have continued to develop over the years since the Intermediaries Byelaw was made. This is seen, for example, with the implementation in 2018 of the EU's Insurance Distribution Directive, the FCA's increased expectations for outsourced arrangements and the management of conduct risk. Our requirements need to evolve to reflect these changes in the regulatory environment.
- The market is investing considerable resources through the LM TOM initiatives to achieve market efficiencies and we need to ensure the delegated authority processes both can take advantage of and are aligned with those changes.

### 3 The principles underpinning the new risk-based approach

22. The proposals in this Consultation Document are based on the following operating principles –
23. **We want to be risk-based.** At present, each year, Lloyd's PMD deals with around 6,000 requests for delegated authority permissions of one type or another or a related activity, all of which generates a 'task' to be completed. These cover new coverholder application requests, requests for change of permissions (including permissions relating to territories and classes of business), change of coverholder details and annual compliance checks. For the more complex risks, it is right that Lloyd's should be actively engaged with the application, but in reality, the majority of these requests do not raise issues that pose a risk for the Society and Lloyd's role in processing them is predominately administrative. But processing these tasks takes time both at Lloyd's and for the requesting managing agent or broker. In the future, we want to focus on higher risk factors. We also recognise that many managing agents have their own sophisticated approach to managing the risks involved and, where appropriate, we want to reduce the burden on all parties by being able to place more reliance on managing agent's own capabilities in assessing the risk of an arrangement.



24. **We want to be consistent and remove duplication of effort.** We believe all third parties, both coverholders and TPAs, should be dealt with in a consistent way. That means both ensuring that our third party network operates to a consistent standard but it also means that participants should not be subject to multiple and different compliance due diligence checks with the accompanying duplicative requests for information. Where possible and appropriate we should drive single data collection from third parties with a single source of validation.
25. **We want to be joined up and use integrated systems.** The market is investing in systems through the LM TOM that are designed to provide straight-through processing to reduce the need to re-key data and to reduce errors. At present the ATLAS and BAR systems do not link to other key systems. We want their replacements to link directly into other DA systems. An example would be where DA SATS is used (the London Market TOM data repository for delegated authority business) as this will support the 'ease of doing business' objective.
26. **We want to make better use of data.** At present the limited integration with other systems offered by ATLAS and BAR means there is a lack of shared data, which impacts the quality of the oversight that can be performed by Lloyd's. We want to make sure we are making the best use of data to drive better informed engagement in support of our prudential oversight of the market.
27. **We want to embed flexibility into our rules and systems.** We want to make sure our rules and processes keep up with changes and can be adapted to address new risks, regulatory requirements and ways of working. In the past we have had difficulty responding to changes because our rules and systems are not sufficiently flexible. We need to future proof our rules and processes as far as possible.
28. **We want to drive efficiencies and remove friction when onboarding third parties.** We need to ensure that the approval and onboarding process is as frictionless as possible without compromising on oversight standards.

***Consultation Question 1 – Do you agree that Lloyd's should adopt a risk-based approach to third party oversight based on the above operating principles?***

## **4 Embedding risk-based approvals and ongoing oversight**

29. A key focus of PMD's current oversight strategy is to embed a risk-based approach to oversight, which focusses on key risk factors and which places reliance on high quality and effective managing agent oversight capabilities.
30. In the area of delegated authorities, we currently deal each year with around 6,000 'tasks' (permission requests) for delegated authority arrangements (either new coverholder approvals or to change existing permissions or related tasks). Many of these requests are low risk. On the other hand, there are an increasing number of tasks submitted to Lloyd's where we do need to engage significantly before approval can be given.

Examples include where the coverholder is seeking permission to write business in a class that is a focus class of business for Lloyd’s or where Lloyd’s considers that the distribution proposal raises questions of increased conduct risk. In these cases we would still want the opportunity to consider carefully the suitability of the proposition.

31. Rather than process each task without regard to the underlying risk factors to Lloyd’s, we want to focus only on high risk issues having regard to (a) the nature of the risks involved, (b) the risk profile of the firm in question, including the product it will service, and (c) the capability of the lead managing agent to oversee that firm.
  
32. Our proposal is that, although Lloyd’s will continue to approve all applications or requests to vary permissions, we will focus our resources on higher risk applications. On this approach (which will involve a change of process but does not require byelaw or other rule changes), a member of Lloyd’s PMD will only need to become involved in the approval process where an application involves specific higher risk factors, which we will prescribe. The system we will use to replace ATLAS and BAR therefore will allow many applications to be automatically approved by the system (although in the case of applications involving overseas licences, a referral to the relevant Lloyd’s country manager may still be required). The diagram below shows the model for how we intend to operate our new approach.



33. To achieve this, applications or requests to vary permissions will continue to be made as now on the Lloyd's compliance system. The relevant system will no longer be ATLAS but its LM TOM funded replacement system, Chorus. Chorus will be configured to triage applications and permission requests having regard to pre-determined risk factors identified through the application process. This robust identification of risk features will trigger referrals in set circumstances, ensuring that risks outside of a managing agent's or Lloyd's risk appetite are identified and addressed. The rules directing the routing of referrals are reconfigurable by Lloyd's and will be kept under review with input from the market associations to reflect changes in risk appetite as well as the legal and regulatory environment.
34. Where an application or variation request is considered to be low risk (i.e. green as above), other than sometimes requiring a review by a Lloyd's country manager, the system will grant approval without involving a member of the Lloyd's PMD team. But where an elevated risk factor is identified the system will refer the application to Lloyd's PMD for further, more detailed consideration. In many cases the referral triggers will mean that Lloyd's only needs to check one issue (such as the class of business) whereas multiple triggers may require a full review of the application by Lloyd's.
35. We have set out in the Appendix the factors that relate to the risk profile of the coverholder application which will be used by the system to triage whether Lloyd's needs to check one or more factors.
36. In terms of the reliance that Lloyd's will place on the sponsoring managing agent's capabilities, we will initially apply a rating as either 'standard' or 'strong' based on the managing agent's minimum standards compliance. In the first instance, a red or amber rating for Customer Standards MS9 will result in a 'standard' rating being applied. A green minimum standards rating will be rated as 'strong'. This rating methodology will be developed over time using other management information available.
37. To provide an indication of what this could mean in practice we have looked at the tasks we dealt with in 2017. We estimate that if we had applied the approach that we are now proposing –
  - 30% could have been dealt with on a self-serve basis
  - 30% could have been dealt with on the basis of a limited review, and
  - 40% would have required a full Lloyd's review.
38. The Chorus system is also being configured to be able to produce the binding authority contract in the required MRC template form from the data provided when registering the binding authority. Lloyd's regulatory requirements and checks will be built in and validated as the user enters the information. This extra optional functionality ensures that binding authorities can be created accurately first time. The benefit of this is illustrated by the fact that currently 90% of binding authorities contain errors when submitted to the bureau. Coverholders will also have access to the system to be able to agree to the terms in the contract electronically allowing for easier and more efficient placing and compliance negotiation.

## Post approval ongoing oversight

39. Lloyd's already undertakes much of the post approval ongoing compliance oversight required for approved coverholders, ensuring that coverholders continue to meet Lloyd's core compliance requirements without the need for the coverholder to deal with multiple managing agents. This is known as 'ongoing coverholder oversight' and is in addition to the processes for approving new coverholders or considering applications to vary their permissions.
40. As we describe in the next section (on claims TPAs) we propose delivering ongoing compliance oversight in parallel, across all approved relationships. This is intended to provide the added reassurance that entities underwriting risks and managing claims on behalf of Lloyd's managing agents continue to achieve compliance requirements through renewal cycles and with minimal additional intervention needed.

## Expected benefits

41. The benefits of this risk-based approach are expected to include –
  - Approvals for more straightforward applications, including certain changes to permissions, will in some cases be automated on the new system. This means that an expected 40% of tasks could be handled without requiring the involvement of a member of the Lloyd's team, allowing the application to be agreed quickly and efficiently.
  - Lloyd's will instead focus on higher risk arrangements ensuring that it is satisfied in those cases that risks have been properly addressed. Through the time savings on low risk applications we estimate that we will be able to allocate an additional 30% of time to high risk arrangements. In other words our proposals should allow for the more efficient allocation of resources both in the market and within Lloyd's.
  - Applications should be dealt with more quickly and the overall approval and onboarding process for new coverholders and TPAs will be made more efficient, utilising integrated systems.
  - Coverholders and TPAs will have the benefit of a single point of contact for annual compliance checks.
  - Lloyd's supervisory oversight will be better informed through the new system linking to transactional data through DA SATS and AiMS.
  - The contract builder functionality of the system will mean that coverholders will be provided with compliant, contract certain binding authorities and that these will be produced by the system reducing re-keying or resubmission due to errors.

**Consultation Question 2 – Do you agree with our proposal that Lloyd’s adopt a differentiated approach to coverholder applications and oversight based on the risk factors identified?**

**Consultation Question 3 – Do you agree with our views of the oversight and practical benefits associated with these proposals for coverholders? Do you believe the benefits identified will make a positive difference to your firm?**

## 5 Delegated claims third party administrators (TPAs)

42. TPAs are often the main contact point for policyholders when they make a claim. The service they provide reflects directly upon Lloyd’s brand and reputation worldwide.
43. In 2017 Lloyd’s issued its thematic review of delegated claims handling<sup>5</sup>. That report found that standards of due diligence for TPAs and other third parties with claims handling authority needed to improve. It also recommended that a consistent and standardised approach be taken to oversight where possible. The proposals in this Consultation Document draw upon those review findings and are intended to promote the enhanced oversight of TPAs whilst also delivering a consistent approach to compliance oversight.
44. Our central proposal is that the new risk-based approval and oversight operating model for coverholders described in this Consultation Document should be extended to TPAs. A key element to this proposal is that TPAs, like coverholders, should be approved by Lloyd’s before they can be appointed to handle claims. The new Chorus system we are designing for coverholder approvals has therefore been configured so that it is capable of also being used for TPA approvals. This approval process would cover not just TPAs appointed to handle claims under binding authority arrangements but all firms with delegated claims authority including those appointed by managing agents to determine claims from open market business or under a line slip. Our proposal, however, is limited to those TPAs with claims handling authority. It is not our intention to extend the approval requirement to other claims-related third party service providers such as adjusters, surveyors, lawyers, claims management firms or first notification firms. Coverholders with authority to handle claims on policies bound or administered by them will not be required to obtain approval as a TPA – their authority to deal with claims will be dealt with as part of the ordinary coverholder approval process.
45. As at present the primary responsibility for selecting and managing the relationship with the TPA will, therefore, remain with managing agents. Managing agents will remain responsible for selecting which TPAs they wish to use, the level of authority to be granted, agreeing the commercial terms and setting the service level expectations with the TPA and monitoring those expectations as well as ensuring appropriate loss fund arrangements are in place.

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<sup>5</sup> Lloyd’s thematic reports can be accessed through Lloyds.com by searching for Lloyd’s market insight. Access is restricted to market participants and users will be required to register to access the content.

46. Our proposals will instead focus on centralising and standardising the approval and ongoing oversight of TPAs. In particular, our proposals mean that –
- Lloyd’s will implement a risk-based approval process for any TPA firm that has delegated authority to determine claims. That approval process will be aligned with the process that is already in place for coverholders and will be based on a set of clearly defined criteria that focus on the corporate suitability of the firm.
  - A firm that receives approval will be given approvals in respect of specified territories and classes of businesses where the firm demonstrates that it has the capabilities to handle claims in that territory. This is consistent with the approach already adopted for coverholders.
  - Firms, once approved, will be able to hold themselves out as a ‘Lloyd’s approved claims administrator’ subject to complying with Lloyd’s usual brand guidelines.
  - We would utilise the same online system as used for coverholders (i.e. the ATLAS replacement, Chorus) for both initial approval and subsequent changes to permissions.
  - Minimum standards will be set for TPA contracts of delegation, which (as is presently required with binding authorities) will be registered with Lloyd’s so that Lloyd’s can identify which TPAs are supporting which coverholders or managing agents.
  - We will extend to TPAs the benefits already provided by the coverholder admissions and ongoing compliance oversight process.
  - We will have reserve powers over TPAs in order for Lloyd’s to prevent and manage risks identified, including powers to review, suspend, revoke or restrict a TPA’s approval. These would only be used where the managing agent cannot resolve the issue or where the TPA is no longer used by the market.
47. We set out in the Appendix the risk factors that would be taken into account when assessing applications to become an approved third party administrator (or for a change of permissions), which may involve us then taking a closer look at an application. Applications that do not have these risk factors (other than where the application requires a review by a Lloyd’s country manager) would be processed automatically by the system, without requiring the involvement of a member from the PMD team.

### **Expected benefits**

48. The proposals are expected to deliver the following benefits –
- Lloyd’s will have better visibility and oversight of a key part of our service network promoting improved standards and excellent customer service.

- There would be a single compliance checks process consistent across coverholders and TPAs.
  - TPAs will have the same benefit as coverholders of a single point of contact for core compliance checks reducing duplication and inconsistency. At present, the market's TPAs provide services on average to three different lead managing agents. Many support more and in some cases as many as 27 lead managing agents.
  - The risk-based approach will mean that a member of the Lloyd's PMD team may only need to be involved for more complex applications allowing applications to be dealt with more efficiently and quickly.
49. These proposals will build on the other initiatives, including TOM, that are being developed in conjunction with the market and the LMA to deliver for the Lloyd's market world class standards of delegated claims handling.

### Existing TPAs

50. TPAs that are already included on the Lloyd's TPA Register will be automatically grandfathered onto the new register of Lloyd's approved TPAs without having to go through a new approval process. Centralised due diligence will subsequently take place for these grandfathered entities over the period of approximately one year. Where possible and appropriate, when undertaking this process, Lloyd's will rely on information already available to managing agents or available on the LME database. Further details regarding the grandfathering process will be provided separately.

***Consultation Question 4 – Do you agree that Lloyd's oversight arrangements, including the requirement for the approval of firms, should be extended to include delegated claims handling?***

***Consultation Question 5 - Do you agree with our proposal that Lloyd's adopt a differentiated approach to TPA applications and oversight based on the risk factors identified?***

***Consultation Question 6 – Do you agree with our views of the oversight and practical benefits associated with these proposals for TPAs? Do you believe the benefits identified will make a positive difference to your firm?***

## 6 Reflecting modern distribution methods

51. The Intermediaries Byelaw strictly prescribes the ways that managing agents can use third parties to distribute products especially for consumer or SME business. In particular, these requirements provide (with limited exceptions) that apart from other managing agents only coverholders can have delegated authority to bind policies on behalf of syndicates<sup>6</sup>. In certain cases, cover can also be distributed through the use of a master or group policies.<sup>7</sup>
52. In addition to the restrictions on who can bind policies under delegated authority, the Intermediaries Byelaw also includes a complete prohibition on coverholders, other than service company coverholders, sub-delegating their underwriting authority to third parties regardless of the controls that may be in place.
53. For a number of years now, these restrictions have successfully served as important controls, reflecting Lloyd's view that uncontrolled delegation poses a material prudential risk to the Society. Distribution methods, however, are evolving and, as currently applied, these requirements no longer accommodate the needs of modern distribution methods. This is especially the case for online sales methods and the sale of standardised insurance products by firms that are often themselves exempt from requiring regulatory permissions to offer the cover. In view of the limited delegated authority involved, these third parties will often see becoming a coverholder as unduly costly and burdensome for the activities they will be undertaking. Our current rules would also only allow delegation of authority to these firms and do not allow sub-delegation by coverholders who are often, in fact, best placed to manage this type of business.
54. We therefore propose to change our requirements to give Lloyd's the ability to address the issues that we are seeing in the market. In making these changes we also recognise that the market will continue to evolve and therefore our rules need to be flexible enough so that they can easily adjusted to meet changing risks and the needs of the market. At present our byelaws are highly prescriptive and are difficult to change, giving us little scope to be flexible as circumstances, require. To address this, we are proposing to make two changes to the Intermediaries Byelaw.
  - a. **Delegation to non-coverholders.** We are proposing to include in the Intermediaries Byelaw a new category of permitted delegated authority that will allow Lloyd's discretion to permit delegation of underwriting authority to firms that are not approved coverholders, provided that there is compliance with the criteria that Lloyd's will have the power to set, including as to the terms of the contract of delegation to be entered into.

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<sup>6</sup> See Intermediaries Byelaw, paragraphs 1 & 3.

<sup>7</sup> Master policies are not considered delegated underwriting under Lloyd's requirements. Under a master policy arrangement, the master policyholder will buy insurance on behalf of the individuals who form a group, for example by virtue of common employment, association, occupation or activity. The members of the group do not buy their own insurance individually but rather will obtain the benefit of the master/group policy by virtue of being in the group. Lloyd's requirements for the writing of master policies are set out in Market Bulletin Y5223.



- b. **Sub-delegation.** We are proposing to remove the strict prohibition against sub-delegation and instead the byelaw will permit sub-delegation to any firm to which delegation of underwriting authority is permitted (subject to controls described below).<sup>8</sup>
55. While these changes are intended to future proof our requirements by allowing us to be more flexible when the circumstances justify it, our view on uncontrolled delegation of underwriting authority and sub-delegation remains unchanged and cautious. We therefore only intend, at this time, to make use of the additional flexibility in the limited circumstances we discuss below. We will, accordingly, be making corresponding changes to other parts of our requirements, including to the 'Code of Practice – Delegated Authorities' to strictly limit the circumstances when non-coverholders can be appointed to bind risks and when sub-delegation will be allowed. The net effect of our changes, therefore, should ensure that we can accommodate the needs of the market but continue to have in place a robust, risk-based and flexible set of controls to oversee this business.
56. We discuss in the next sections our proposals, within this new framework for permitting the appointment of 'distributors' by managing agents and coverholders and to allow greater flexibility in selling through online platforms as well as our proposals for permitted sub-delegation by coverholders. Following the outcome of this consultation, we will be publishing the detailed rule changes to implement these changes.

### **Introduction of a new category of delegated third party – 'Distributors'**

57. We continue to view the use of coverholders or master policyholders as effective distribution channels for the large majority of consumer policies sold at Lloyd's. But they do have limitations. Generally, the coverholder model only applies for intermediaries who are themselves, regulated intermediaries and are specialist in selling insurance. Master/group policy arrangements are only suitable in very limited circumstances, namely where the master/group policyholder represents a pre-defined and genuine group on whose behalf it wants to obtain insurance. It is not a suitable mechanism for offering insurance to the general public.
58. Increasingly, however, there are circumstances where consumers may wish to buy simple insurance products that do not individually require complex or, indeed, any underwriting and where the premium will be a relatively small amount. This insurance may be sold on its own or in addition to another non-insurance product being purchased by the consumer. Very often this type of insurance is sold by or through a firm that is not a regulated insurance intermediary but may be, for example, a retailer of consumer goods. Examples of such arrangements include –

**Example 1** – Company A sells tickets online for entertainment events, including the theatre and concerts. It wishes to offer insurance to customers to cover the cost of the

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<sup>8</sup> Any permission to sub-delegate will, for the time being be limited to business with risk locations outside of the EU. Business written through Lloyd's Brussels is dealt with separately and will not allow for sub-delegation.

ticket in the event that the customer is unable to attend the event for unforeseen circumstances. There is no individual underwriting of the risk as everyone is able to purchase the insurance on the same terms and for the same price, when they are buying their tickets online.

**Example 2** – Company B is a furniture retailer. It wishes to offer customers insurance to provide cover in the event that the purchaser accidentally damages the newly acquired furniture. Customers are able to choose between a Bronze, Silver and Gold option for cover. Each option offers different benefits but there are no differences in the terms offered within each category and the price for each category is fixed. The customer is able to choose which of the options it wishes to buy.

59. The companies selling the insurance could apply to become a coverholder but, in most cases, as the retailer is not a specialist insurance firm, this route would not be suitable or realistic. Adding a coverholder into the distribution chain to take on the role of binding the risks may bring the arrangement into the current rules but in so doing may simply add costs with no corresponding benefit and very often will be impractical; the coverholder will often not have any direct relationship with the customer. In some cases, master/group policies may be a suitable option but often, such as in the examples given, there will not be the required 'group'.
60. We believe that provided appropriate controls are in place, our rules should facilitate a more risk-based approach to allowing these sorts of firms to sell Lloyd's policies without the requirement for them to become coverholders. Utilising the additional flexibility that will be allowed by the changes we plan to make to the Intermediaries Byelaw, we propose introducing a new limited category of firms which managing agents can authorise to sell their products, to be called 'distributors'. Where managing agents comply with the new requirements for distributor arrangements they will be permitted to delegate limited underwriting authority to the distributors without the prior agreement of Lloyd's. We believe coverholders, where they have demonstrated to Lloyd's that they have the necessary capabilities, should also be allowed to authorise distributors to sell their products.
61. We believe that this type of business is suitable to be written at Lloyd's without prior Lloyd's approval subject to a modified risk-based control framework. These controls would recognise that distributors do not have any underwriting discretion or complaints or claims authority and therefore they have a reduced risk profile in that regard. At the same time, distributors may not be specialist insurance firms but will be dealing with consumers and so there is increased conduct risk. Lloyd's is also mindful that the Financial Conduct Authority (FCA) has published two Thematic Reviews that identified industry weaknesses in the way outsourced arrangements are managed by insurance firms, particularly where authorised representatives are appointed.<sup>9</sup> Managing agents will therefore be expected to have robust arrangements in place for carrying out due diligence on distributors before appointing them, complemented by ongoing and appropriate monitoring of the distributor.

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<sup>9</sup> See the FCA's Thematic Reviews: 'TR15/7: Delegated authority: Outsourcing in the general insurance market' (2 June 2015) and 'TR16/6: Principals and their appointed representatives in the general insurance sector' (22 July 2016).

62. Accordingly, the controls that would apply to appointing a distributor would include –

- All insurance sold by the distributor must be sold on the basis of pre-set terms and for a premium which should generally be automatically generated by an electronic system agreed by underwriters. Cover must be available to any customer who meets the prescribed criteria for purchasing the product. There can be no individual risk selection discretion exercised by the distributor.
- The contract with the distributor (the ‘distributor agreement’) must comply with the requirements Lloyd’s will prescribe which will include contractual rights to require the binding of risks to cease where there is cause.
- The distributor must have no claims or complaints handling authority.
- All distributor arrangements will need to be prior registered using Chorus, the online replacement system for ATLAS which will verify that the arrangements do not require coverholder approval.
- Lloyd’s will, as part of managing agent reviews, pay particular attention to whether managing agents are closely overseeing their distributor arrangements including the conduct risk of selling policies in this way. Because Lloyd’s believes only managing agents that have demonstrated they can meet the Lloyd’s Minimum Standards that relate to conduct risk should be permitted to enter into these arrangements, Lloyd’s will, at least initially, only allow syndicates to write distributor business where they are rated green for Customer Standards MS9.
- Distributor arrangements will, initially, only be permitted for insurance sold in the UK. Lloyd’s wishes to see distributor arrangements rolled out in a controlled way to ensure the new arrangements are working well before they are implemented worldwide. Different local regulatory rules may also apply in jurisdictions outside of the UK and Lloyd’s wishes to ensure that appropriate guidance is available on Crystal for those territories. This will take time to produce. We therefore consider that it would be prudent to limit the writing of distributor business outside of the UK.

## Internet selling

63. Online selling is now an important distribution channel for insurance. Some managing agents or coverholders may use their own proprietary systems for selling via the internet but very often third party firms are involved in providing the online distribution expertise, including the platform through which risks are bound. The insurer will provide the terms and rating rules to be applied, but once uploaded, the third party system will operate automatically to bind risks. This can raise issues of delegation and sub-delegation under our current requirements –

- while the managing agent/coverholder may be able to access the system to change rates and terms (and the third party provider may have no involvement in this) nevertheless, in the final instance, the insurance is being bound on the third party’s system on behalf of Lloyd’s underwriters. In addition, as well as providing IT expertise the third party firm will very often provide expertise on how to market insurance products online. The third party provider will also often be actively involved in designing how the product should be presented online and in marketing the facility to consumers. In these cases, there is often very little difference between these types of online arrangements and traditional coverholders.

However, as with distributors, requiring the online provider to become an approved coverholder is often impractical and disproportionate to the risks that need to be addressed.

- where coverholders want to use third party online systems as a distribution channel, issues of sub-delegation can arise.
64. Like distributors, we believe that it should be possible to make use of third party online systems to distribute insurance products without requiring that the third party provider becomes an approved coverholder. Once the Intermediaries Byelaw has been amended, we propose amending the 'Code of Practice – Delegated Authorities' to better facilitate internet selling. Provided that the requirements are met then managing agents will be permitted to use online systems for distributing insurance direct to customers without requiring that the system provider becomes an approved coverholder. We also propose extending this approach to allow coverholders to sell insurance through third party providers, provided the same requirements are met.
65. The important feature of these third party systems that allows us to adopt a modified control approach is that the underwriting is fully automated and the third party does not have any input in the terms or rates used.
66. There are, however, risks that still need to be considered and we will expect managing agents to have processes in place to address these. First, it will be important for managing agents (or their coverholders on their behalf) to carry out proper due diligence and testing of the electronic systems being used. The way in which the products are marketed online, often to consumers, can also increase the conduct risk and managing agents will need to be able to show they have considered this. Because the internet is borderless, difficult licensing questions can also arise where individuals from different jurisdictions may look to buy policies from the online platform. It will therefore be important for managing agents to check the way in which the platform can be accessed by customers to ensure that policies are always only sold in accordance with Lloyd's trading licences. Where appropriate, controls should be included to ensure policies can only be sold to customers in the target risk location. The managing agent or coverholder should also have access to detailed and regular (ideally real-time or daily) reports of the business being bound.

### **Sub-delegation by coverholders**

67. The sub-delegation of underwriting authority by a coverholder to another firm is presently prohibited by Lloyd's in all circumstances. Experience has shown that where underwriting authority is sub-delegated managing agents can very quickly lose the ability to exercise proper control over the underwriting, putting policyholders and members of Lloyd's at risk. We know that other regulators are often similarly cautious about permitting extended distribution chains involving sub-delegation of underwriting authority.
68. Lloyd's therefore continues to remain extremely cautious about permitting sub-delegation and we have taken as our starting point that, except where expressly permitted by Lloyd's, managing agents should not allow the sub-delegation of underwriting authority or the authority to issue insurance contractual documentation.

69. But where sub-delegation can be properly controlled then we do not believe that our rules should automatically prohibit those arrangements. In particular, with the development of electronic systems managing agents and coverholders can often control in real-time or near real-time the distribution of their insurance products through online systems. We therefore believe that there is greater scope to permit some sub-delegation of authority where it is properly controlled.
70. Lloyd's is therefore proposing to amend the Intermediaries Byelaw to remove the automatic prohibition on sub-delegation. At the same time, we will prescribe the circumstances when sub-delegation is permitted. Initially, this will be limited to the following circumstances, where we believe the risks associated with sub-delegation can be managed –
- To permit sub-delegation by coverholders to distributors (as discussed above).
  - To permit sub-delegation by coverholders to third party providers of online distribution systems (as discussed above)
  - To permit a coverholder to sub-delegate their authority to bind risks and issue contractual documentation to other approved Lloyd's coverholders, where Lloyd's has given permission.
71. With regard to the last of the cases listed, it is not our intention to allow sub-delegation of substantial underwriting authority from one coverholder to another. We continue to believe that where a coverholder has substantial underwriting authority then its binding authority agreement should be with the managing agent and not another coverholder. There are, however, arrangements where coverholders (a 'master coverholder') operate networks of other insurance intermediaries who are given authority to access the master coverholder's rating matrix and bind risks using the quotes they obtain from the system. Where, on an application from the managing agent, we are satisfied that the appropriate controls are in place then we will give permission for the coverholder to sub-delegate as long as the sub-coverholder has the correct class of business and territorial permissions.
72. We will set out in the 'Code of Practice - Delegated Authority' the conditions that need to be met in each case to sub-delegate in accordance with our new rules. In summary these would be –
- The coverholder intends to sub-delegate authority to another approved coverholder or a 'distributor' and where it has express authority in its binding authority to sub-delegate.
  - Where a contract of delegation will be in place between the coverholder and the sub-delegate that complies with Lloyd's requirements.
  - Except where there can be no variation in the premium or terms to be applied, the sub-delegate must only be authorised to bind risks through the use of an online system that contains appropriate and robust security features and operating controls. This will include that the system must have real time (or near real time) reporting functionality and that the system can be disabled by the master coverholder as required.

## Expected benefits

73. The expected benefits from amending our rules to introduce the new category of distributor and from removing the automatic prohibition on sub-delegation are that a number of schemes the market currently does not place on the Lloyd's platform could be brought to Lloyd's. Also, the placement of some schemes that are currently operated in the market could be simplified.

***Consultation Question 7 – Do you agree with our proposal that the Intermediaries Byelaw be amended to give Lloyd's the discretion in appropriate cases (1) to permit delegation to firms that are not approved coverholders (at this time being 'distributors' or third party online platform providers), and (2) to permit sub-delegation?***

***Consultation Question 8 – Do you agree with the controls set out in our proposals regarding the use of distributors and third party online platforms?***

***Consultation Question 9 – Do you agree with our proposed approach (including the proposed controls) to permitting sub-delegation by coverholders?***

## 7 Other changes to the Intermediaries Byelaw

74. At the same time as amending the Intermediaries Byelaw to implement the changes outlined above, Lloyd's is also proposing to make a limited number of other changes to the Intermediaries Byelaw and the Requirements made pursuant to the Intermediaries Byelaw, with consequential amendments to the Definitions Byelaw and other byelaws. The main changes are as follows –
- a. Lloyd's is proposing to introduce a new definition of 'consortium agreement'. Presently, these contracts of delegated authority between managing agents are treated as falling within the definition of registered binding authority (see paragraph 1(d) Intermediaries Byelaw). Lloyd's considers, however, that just as line slips are recognised separately from binding authority agreements the same should be the case for consortia arrangement. All three arrangements have common features, as contracts of delegated authority, but they are also all treated in different ways by the market with different Lloyd's regulatory controls applying. The proposed changes to the byelaws will ensure that is better reflected in the Intermediaries Byelaw. In addition to introducing a new definition of consortium agreement, we are also adopting a new defined term of 'contract of delegated authority' as a collective term for the various types of delegated authority agreement that will now be recognised in our requirements.
  - b. At present, Lloyd's maintains registers of approved coverholders and binding authorities. We are proposing to extend the cases where persons given delegated authority must be registered, as well as their contracts of delegated authority, so that as a default we will generally expect everyone given delegated authority to be recorded by us (although there will still be cases where we may not require this). Operationally, this will be facilitated through, Chorus, the system replacing ATLAS

and BARS. A limited change is required to the Intermediaries Byelaw to allow for this.

- c. When referring to coverholders the byelaws variously refer to both the defined terms 'coverholder' and 'approved coverholder'. The byelaws also variously refer to the defined terms 'binding authority' and 'registered binding authority'. Since the removal of the 'restricted coverholder' category, all coverholders and binding authorities must now be registered and there is therefore no need to have separate defined terms. It is therefore proposed to simplify the definitions by removing the references to 'coverholder' and 'registered binding authority' with the necessary consequential changes to the Intermediaries Byelaw, the Underwriting Byelaw and Insurance Certificates Byelaw, where these terms occur. In their place will be inserted the defined terms: 'approved coverholder' and 'binding authority'. These will now be the only defined terms to be used.
- d. Presently Lloyd's requirements for binding authorities (paragraph 10(g) to (i) of the Requirements made pursuant to the Intermediaries Byelaw) provide that binding authorities must include a list of every person at a coverholder who has authority to bind policies, issue contracts of insurance or to agree claims on policies bound by the coverholder. We know that the market finds this an unduly onerous requirement given that, particularly at larger coverholders, there can be regular changes of personnel in the ordinary course of business. While in appropriate cases managing agents may still need to obtain from coverholders a list of the persons at the coverholder who have these authorities, we recognise that this information does not need to be routinely included in the binding authority. We are therefore proposing to change the requirements for binding authorities so that only the person with principal authority for these functions needs to be identified in the binding authority.
- e. In view of the United Kingdom's scheduled departure from the European Union, we need to make some changes to the criteria we apply when registering Lloyd's Brokers, which are set out in the Requirements made pursuant to the Intermediaries Byelaw. In substance, our approach is not changing and the amendments we are making are merely intended to put brokers from European Union countries who are seeking to become Lloyd's Brokers into the same position as firms from other parts of the world. At present, our rules make a limited distinction between the two.

***Consultation Question 10 – Do you have any comments on the proposed other changes to be made to the Intermediaries Byelaw?***

## Appendix - Risk ratings to be adopted by Lloyd's

### DA Risk Based Oversight – System supported triage rules

Notes:

R (Full Referral) means Lloyd's will undertake a full assessment

RR (Restricted Referral) means Lloyd's will only assess the higher risk factors

Application Features covering applicant, product, geography	Managing Agent Capability Rating <b>Standard</b>	Managing Agent Capability Rating <b>Strong</b>
LBS application	R	RR
Sole trader	R	R
Previously cancelled binders	R	R
Previously rejected applications	R	R
Previously deregistered by local regulator	R	R
PI Claims in the last 5 years	R	RR
Portfolio Review Class	R	RR
Criminal convictions of any director or controller (unless spent)	R	R
Insolvency or bankruptcy of any director or controller	R	RR
Record of overdue audit findings	R	✓
Record of open/unresolved OCO checks	R	✓
Poor performance record for complaints	R	✓
Arranges master policies	R	✓
Multiple parties in the sales/distribution chain	R	✓
Includes sub-delegation	R	R
Sales through multiple outlets	R	✓
Sales via broker operated third party platform	R	R
Sales to consumers through call centres	R	✓



Binder EPI >£5m or 1% of syndicate GWP	R	✓
CH produces more than 20% of market business	R	R
Projected to cover >20k eligible complainants	R	✓
Discretion to write <100% of a risk	R	R
Sales through sub delegation or online platforms where rate adjustments are permitted	R	✓
Trading in high risk regions	R	RR
Profit commissions linked to targets not performance	R	R
Profit share commissions where claims handling is delegated to the CH	R	RR
No segregation of UW and claims handling	R	RR
Additional customer charges apply	R	RR
Previous record of high loss ratio/high combined ratio	R	RR
Previous record of or projected to be very low loss ratio	R	RR
Acquisition costs >50%	R	RR
High static commissions	R	R
Authority to deny claims and handle complaints	R	✓
Claims authority previously restricted or removed	R	R
Unlimited claims handling authority	R	✓
High concentration of catastrophe exposed business	R	RR
TPA handles a high concentration of the market's claims	R	RR
Limited system capabilities	R	✓
Unable to capture and record required v5.1 information	R	R
Insufficient policies, procedures and processes	R	✓
No established means of measuring customer outcomes	R	R