

LLOYD'S

LLOYD'S MINIMUM STANDARDS MS9 - RESERVING

OCTOBER 2017



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MINIMUM STANDARDS AND REQUIREMENTS

The Minimum Standards are statements of the business conduct required by Lloyd's, established under relevant Lloyd's Byelaws. The Requirements represent the minimum level of performance required of any organisation within the Lloyd's market. All managing agents are expected to comply with the Minimum Standards.

Within this document the standards and supporting requirements are set out in the blue box at the beginning of each section. The remainder of each section consists of guidance which explains the standards and requirements in more detail and gives examples of approaches that managing agents may adopt to meet them.

GUIDANCE

This guidance provides a more detailed explanation of the general level of performance expected. It is a starting point against which each managing agent can compare its current practices to assist in understanding relative levels of performance. This guidance is intended to provide reassurance to managing agents as to approaches which would certainly meet the Minimum Standards and comply with the Requirements. However, it is appreciated that there are other options which could deliver performance at or above the minimum level and it is fully acceptable for managing agents to adopt alternative procedures as long as they can demonstrate how these meet the Minimum Standards.

DEFINITIONS

AFR - Actuarial Function Report

GQD - Gross Quarterly Data

MI - Management Information

NEDs - Non-Executive Directors

ORSA - Own Risk and Solvency Assessment.

PRA - Prudential Regulation Authority

SAFs - Syndicate Actuarial Functions

SAO - Statement of Actuarial Opinion

TAS - Technical Actuarial Standards

The Board - Where reference is made to the Board in the standards, agents should read this as Board or appropriately authorised committee. In line with this, each agent should consider the matters reserved for the Board under the Governance Standard in order to evidence appropriate full Board discussion and challenge on these subjects.

TPD - Technical Provisions Data

SECTION 1: BOARD RESPONSIBILITY

RS 1.1

Board Responsibility

The Board of the managing agent shall be responsible for setting reserves.

The Board of the managing agent shall:

- *be responsible for setting reserves for both Financial Accounting and Solvency;*
- *understand the key assumptions, methodologies and uncertainties associated with the reserves;*
- *provide objective challenge to the process used to set the reserves and the recommendations made by the reserving function;*
- *direct appropriate action given movements in historical reserves, in particular seeking assurance on reserve adequacy following any deteriorations; and*
- *ensure there is consistency of assumptions between reserving, pricing, capital modelling and financial reporting.*

Setting reserves

Reserve setting is the responsibility of the managing agent's Board. If Lloyd's believes there is an unduly high risk that the reserves will prove to be inadequate, Lloyd's will engage closely with the agent and expect the board to fully support this engagement.

Boards should ensure that all requirements relating to reserve setting are met. The Board's responsibility for setting reserves extends to those reserves set for unexpired risks, which under Solvency II may be less than the unearned premiums.

Any committee providing recommendations to the Board does not replace the requirements of the Board. In many managing agents, there is a reserving committee that brings together the appropriate experts and makes a recommendation for the Board to consider. Lloyd's supports the use of such a structure when the managing agent believes it works best, but the existence of an expert reserving committee does not remove the requirement for the Board to give due consideration to the reserve decisions and to be ultimately responsible for the result.

Key assumptions, methodologies and uncertainties

The Board should understand the key assumptions, methodologies and uncertainties underlying the reserves. This includes the key reserving judgements made in light of the current point in the market cycle, socio-economic factors affecting the insurance market as well as external changes or shocks for expected changes, or uncertainties, in legislation.

Where the Board does not retain the relevant knowledge they should seek training either internally within the managing agent or externally.

Objective challenge

The Board should allocate sufficient time to consider reserves, and must provide an objective challenge to the proposals brought to them. The information provided to the board must be sufficient to support this level of challenge. Lloyd's may require copies of Board packs and minutes to review the discussions that were held, and will look to the Board as the ultimate authority for questions on reserves. As well as the above information, Lloyd's may request access to independent non-executive directors (NEDs).

The Board should challenge the process that had been used to set the reserves. As part of their challenge the Board should consider the historical experience of the Syndicate against expectation

and the validity of use of assumptions from other processes, such as business planning, in reserve setting. In addition credit taken for initiatives/changes which do not yet have a track record is expected to be closely scrutinized by the board.

Appropriate action

In response to adverse movements in reserves the board is expected to direct appropriate action to understand the underlying drivers of these movements and assurance on the adequacy of the latest reserves. This should include, but not be limited to, consideration of the validity of any credit taken for any process changes or remedial action/improvements in underwriting or claims.

In the event of material or persistent reserve deteriorations Lloyd's expects a comprehensive plan of these actions to be available on request.

Consistency

Information and assumptions used in the reserving process should be linked and, where appropriate, consistent with those used in capital modelling, pricing and financial reporting. Any use of inconsistent assumptions should be clearly justified.

SECTION 2: BOARD INFORMATION

RS 2.1

Board Information

Managing agents shall ensure that sufficient information is supplied to the Board to fully inform their responsibility for reserve setting and providing objective challenge.

Managing agents shall ensure that information provided to the Board:

- *is accurate;*
- *is accompanied by analysis which includes discussion of emerging experience, key assumptions, uncertainties and market conditions; and*
- *includes relevant external information*

In order for the Board to reach conclusions on reserves and provide the necessary objective challenge they should be provided with accurate, appropriate information.

Lloyd's expects the managing agent to provide, on request, copies of any information relating to reserving.

Accuracy

The managing agent should have appropriate processes and procedures in place to ensure the accuracy of reserve information provided to the board.

Analysis

The information provided should be accompanied by analysis covering material aspects of the reserves. The items listed in this section do not represent a checklist for fulfilling this requirement; the managing agent must be satisfied that the information is complete and appropriate, including that attention is appropriately drawn to more material or higher risk areas.

The information should cover both internal and external factors including any emerging risks, emerging experience and adjustments made in light of this; changes in exposures, placement types and terms and conditions; and information on market conditions. The information on market conditions is relevant due to the reserving cycle - reserves set at times of weaker rating environments have historically been more prone to deterioration than those set at points with higher premium rating. The Board should be aware of this reserving cycle effect and consider whether any adjustment to account for this is appropriate.

Relatively high risk areas should be covered in more detail. Examples of high risk areas include, but are not limited to: large accounts, lines of business with greater inherent uncertainty, new lines, accounts with higher claims than expected, lines where there has been a change to the underwriting, lines where there has been a material release due to changes in methodology and assumptions, lines where there has been deterioration since the previous reserve analysis and lines with special reinsurance characteristics such as a risk of exhaustion.

The board should ensure an appropriate level of internal and external actuarial analysis is provided to support their reserve setting responsibility. If an external actuary has recommended reserves or has provided an independent estimate of the reserves the Board should consider their analysis and have the opportunity to challenge this. A good practice is for non-executive directors to meet the external actuary without the executive Board members in attendance.

Board Feedback

The managing agent should provide a channel whereby feedback can be provided from the Board to the reserving team should there be a need for any clarification, additional analysis or changes to the

reserve estimates. There also needs to be in place a mechanism whereby the information or reserve estimates can be re-reviewed by the Board following feedback.

External information

The Board should be aware of any guidance and feedback information relevant to reserving provided to the syndicate by Lloyd's or other recognized body such as the Prudential Regulation Authority ("PRA").

SECTION 3: ACTUARIAL FUNCTION

RS 3.1

Actuarial Function

Managing agents shall ensure that an Actuarial Function is in place.

Managing agents shall ensure, in respect of coordination of the calculation of technical provisions, the Actuarial Function carries out the duties required to meet all Solvency II tests and standards.

- *ensuring the accuracy, completeness and appropriateness of data;*
- *ensuring the use of appropriate methods and assumptions;*
- *undertaking an analysis of actual versus expected experience as well as other appropriate validations; and*
- *producing a report ('The Actuarial Function Report') to the Board, at least annually, documenting all tasks undertaken, identifying deficiencies and making recommendations to remedy these deficiencies.*

Under Solvency II there is a requirement for all firms to have an Actuarial Function in place. This requirement applies both to Lloyd's centrally and managing agents.

Managing agents will have Syndicate Actuarial Functions (SAFs) led by the Chief Actuary. The Chief Actuary should be appointed under the PRA's Senior Insurance Manager's Regime in Senior Insurance Management Function 20 (SIMF20). Lloyd's expects to be notified of any prospective change of Chief Actuary. Lloyd's maintains a record of Chief Actuaries and will use these details to communicate key messages relevant to reserving. It is the responsibility of the Chief Actuary to ensure this information is appropriately disseminated to their team.

The SAF governance structure is not prescribed by Lloyd's. Managing agents should ensure that the structure in place allows the function to comply with all Solvency II specifications and PRA guidance, such as being independent of revenue-generating functions and providing robust challenge. These requirements do have regard to the nature, scale and complexity of the business.

Lloyd's requirements for SAF reporting, and associated guidance is provided on [Lloyds.com](https://www.lloyds.com).

SECTION 4: RESERVING PROCEDURE

RS 4.1

Reserving Procedure

Managing agents shall ensure they have a robust reserving procedure.

The managing agent shall ensure that:

- *those conducting the reserving analysis have appropriate skills and knowledge;*
- *the procedure incorporates justification and validation of the methods used;*
- *feedback loops are included in the procedure;*
- *the procedure is in line with guidance from Lloyd's, the PRA and any other relevant professional body; and*
- *internal audit periodically review reserving processes including validation of methods and results.*

Appropriate Skills and Knowledge

The managing agent shall ensure the personnel conducting the reserving analysis have appropriate skills and knowledge of both reserving techniques and also market issues impacting on reserving decisions.

Managing agents should be clear on the roles and responsibilities within the reserving procedure. Terms of reference for each function involved in the reserving process are expected.

In view of the importance of syndicate technical reserving teams to Lloyd's oversight of the market's reserve strength, Lloyd's would expect to be notified of any prospective change in the leadership of the team.

Justification and validation

There is no prescribed structure for the reserving procedure. The Board must take its own view on ensuring a robust procedure is in place, including justification and validation of the reserves.

Usually, several methods for estimating liabilities will be considered and the final choices must be justified clearly with reasoning, limitations and uncertainty set out. The methods used by the technical reserving team should be properly validated especially when they depart from the methods normally used. In particular, Lloyd's attaches considerable weight to analyses of emerging experience against the expectation contained in previous analyses and the actions taken based on the outcome of this analysis.

Where estimates are made by different parties or on different basis the syndicate is expected to rationalize the drivers of difference between these.

Feedback loops

The reserving procedure should incorporate feedback loops to allow comments from the board and other committees to be reflected in the reserving work.

Guidance

The technical reserving team will be expected to know any Lloyd's and other regulatory requirements, and in particular should pay careful attention to market bulletins and the Lloyd's Valuation of Liabilities rules, issued annually.

Over the normal course of reserve oversight Lloyd's expects to query and make periodic requests for additional information or meetings with managing agents and/or their advisors. It is expected that

staff and materials will be made available in a timely manner and access granted to external advisers where appropriate.

Lloyd's will identify areas of concern through observation of trends, the exposure of syndicates to thematic issues (for example by line of business) or by evidence of deficiency in syndicate processes such as those indicated by inability to supply adequate and accurate data. Deteriorations are monitored but are not the sole indicator of concerns, a "very prudent" reserve based on a poor procedure would still be a concern.

Where Lloyd's considers that a syndicate may have an inadequate reserving process or practice they will engage closely with the syndicate. Lloyd's may impose requirements on the syndicate such as more stringent reporting, (additional) independent analysis or explicit capital loads.

As part of monitoring any issue Lloyd's will meet with the syndicate at quarterly intervals, with timing to coincide with the reserving work cycle. Each quarter's reserves are important: the half year reserves form the basis of the solvency position used in coming into line in November and for interim results; the third quarter reserves are often a basis for the year end; the year end is the primary solvency analysis; and the first quarter reserves give an early indication of how a year has progressed. When engaging quarterly, Lloyd's may wish to understand and potentially influence the outcome of the exercise in good time, often before the quarter's reserves are finalised.

Internal Audit

Lloyd's would expect the audit committee and internal audit to review the reserving process periodically. The frequency of the internal audit review is not prescribed but should be outlined as part of the Syndicate's risk management process; including conditions which would trigger more frequent review. It is expected that the frequency of these reviews would be higher where there have been continual deteriorations or where there have been material findings from previous audits or by Lloyd's.

SECTION 5: STATEMENT OF ACTUARIAL OPINION

RS 5.1

Statement of Actuarial Opinion

Managing agents shall ensure that a Statement of Actuarial Opinion (SAO) is obtained

Managing agents shall ensure that:

- *the SAO is provided annually in respect of each open year of a syndicate;*
- *the SAO complies with the latest Lloyd's Valuation of Liabilities rules;*
- *the SAO results are considered by the Board; and*
- *there is an appropriate relationship between figures underlying the SAO work and those reported to Lloyd's in solvency returns.*

Lloyd's requires a Statement of Actuarial Opinion (SAO) to be provided by a suitably qualified actuary in respect of each open year of every syndicate. Suitable qualification includes holding a relevant practicing certificate issued by the actuarial profession. The latest criterion including qualifications for practicing certificate actuaries are described on the actuarial profession's website.

The SAO must comply with the latest Valuation of Liabilities Rules, and any related requirements, issued by Lloyd's.

Managing agents should ensure a process for ongoing SAO provision is in place, and this process has clear ownership. Historical provision of a SAO is not evidence of the existence of a process to ensure its provisions going forwards.

Managing agents should provide the SAO results to the board for consideration. They should also ensure there is a mechanism for the Board to provide any feedback resulting from consideration of the SAO to both the reserving team and the SAO provider. This should be provided in sufficient time such that any resulting changes can be actioned prior to submission of the SAO and finalisation of any results.

Lloyd's will use the SAO to assess reserve margins and profit in the unearned premium reported by managing agents in solvency returns. Managing agents should ensure that these submissions are consistent with the SAO where appropriate, in line with the latest Lloyd's guidance.

Managing agents should consider the merits of rotation of the SAO actuary periodically. It is expected that documentation on the rationale of the appointment is available should the same individual sign the SAO for more than four consecutive years.

SECTION 6: DOCUMENTATION

RS 6.1

Documentation

Managing agents shall have an appropriate documentation associated with the reserving process.

Managing agents shall ensure that the documentation associated with the reserving process and results is complete and in accordance with Technical Actuarial Standards.

In addition to the formal submissions required Lloyd's may request copies of any item of documentation related to the reserving process.

Documentation should include both the processes involved in the reserving work and reporting on results. The former is expected to include terms of reference for the roles/functions involved and documentation of the processes to be followed.

There must be appropriate disclosure to auditors and SAO-signing actuaries and the documentation should show what has been disclosed and how. Actuaries will have to meet the various requirements of the actuarial standards, and it is also expected that non-actuaries providing reserving advice to the Board would adhere to equivalent standards.

It is expected that different levels of documentation, for example detailed reports on technical procedures compared to output prepared for the board, will take account of their audience and be tailored appropriately.

SECTION 7: RESERVING DATA

RS 7.1

Data Governance

Managing agents shall ensure that they have appropriate data governance structures and procedures in place for reporting of reserving data to the internal Actuarial Function and to Lloyd's.

Managing agents shall:

- *ensure that data governance is agreed by the board;*
- *appoint a nominated director(s) with accountability for governance of reserving data provided to Lloyd's;*
- *ensure that roles, responsibilities and reporting lines, for the management of reserving data are clearly defined; and*
- *have appropriate procedures in place to allow timely recording and production of reserving data, the suitability of which are reviewed annually.*

Policies on data governance should be agreed by the board and should have regard to the data required by the internal reserving function, any external service providers, the PRA and Lloyd's.

The nominated director(s) with accountability for data governance should have a sufficient level of authority and access to resources and information to enable him/her to carry out his/her responsibility.

The data governance framework should capture the structures and procedures, including triggers for escalation, to support the quality of reserving data. Managing agents should have a framework in place which shows clear oversight of the quality of internally produced reserving data, responsibilities and accountabilities. In addition it should ensure appropriate, accurate, complete and timely reporting to support required governance and management decision making processes, together with prompt detection of issues.

Lloyd's expects managing agents to ensure that written data policies, procedures and standards are kept under regular review, at least on an annual basis or where there is a material change impacting the policy such as a change to a stakeholder. These documents should include the responsibilities and accountabilities of the various stakeholders across the managing agent and the quantity and quality of data metrics reported to management.

Data management is often a separate responsibility to reserving and it is required practice that there is a clearly identified owner of the data used. The reserving team should have a strong input into the data that is collected and how it is stored, and should review the data carefully before relying on it. The reserving team should also be aware of, and the reasons for, any adjustments to the data which may have a material impact to the reserve estimates.

The governance in place is expected to include the need for compliance with Lloyd's requirements and deadlines for reserving data returns.

RS 7.2

Systems and Processes

Managing agents shall have systems and processes in place to record relevant reserving data and use the output for reporting to management and to Lloyd's.

Managing agents shall have systems and processes in place:

- *to record reserving data which is sufficient in granularity and coverage to enable the Actuarial Function to appropriately monitor experience*
- *have appropriate systems and tools in place to enable production of reserving data returns to Lloyd's at sufficient granularity*
- *to meet other appropriate external regulatory requirements and guidelines.*

Managing agents should ensure that they have systems, modelling tools and analysis methodologies in place to meet the requirements of the business. It is important that systems and processes relating to reserving data can produce timely and accurate returns to executive management, the board and ultimately to Lloyd's and external regulators in the required format. Any system or process changes should maintain compliance with requirements of the data.

RS 7.3

Data Quality

Managing agents shall ensure that reserving data reported internally and in returns to Lloyd's and other external regulators is appropriate, accurate, complete and produced in a timely manner.

Managing agents shall:

- *comply with Lloyd's instructions for the preparation of reserving data returns;*
- *ensure reserving data returns are appropriate, accurate, complete and submitted on time;*
- *ensure the reserving data can be reconciled to the syndicate accounts, Management Information and is consistent with that reported to Lloyd's and other external regulators; and*
- *have a schedule in place for reserving data reporting time frames.*

Executive management and the Board should be aware of the returns that are being issued externally to Lloyd's and to regulators.

Syndicates should establish and maintain the necessary arrangements to ensure that consistent and timely electronic delivery of the submissions is possible without material interruption due to human or technical failure.

There is an expectation that reconciliation of returns to internal Management Information and other Lloyd's returns should be available. Lloyd's expects managing agents to be able to demonstrate how the information reconciles and provide an audit trail of any allocation required for Lloyd's returns.

Reconciliations required as part of submissions to Lloyd's are outlined in the instructions for each return.

RS 7.4

Quality Control Process

Managing agents shall have processes in place to review the systems and controls framework ensuring reserving data is accurate and complete.

Managing agents shall ensure that:

- *where appropriate the data reconciles to the syndicate accounts as well as between syndicate returns*
- *there is regular exception reporting to identify potential variances or control failures in recording and producing reserving data and these are investigated and escalated as appropriate; and*
- *the systems and controls framework for reserving data is subject to regular and appropriate internal audit review.*

Throughout the production process of data, from recording to reporting, Lloyd's expects controls to be in place to ensure accuracy and completeness of data, which can include data error reports / validation reports / exception reports etc. For example, exception reports may address large case estimates, paid or IBNR movements, entries with unusual currencies for the syndicate, blank data fields where information would be expected to have been entered etc.

There should be a process of checking the quality of data on a timely basis with due regard to the materiality and the potential risk associated with inaccuracies. If data entry is outsourced accountability and responsibility for data quality remains with the managing agent.

Internal Audit are required to undertake regular reviews of the systems and controls for underwriting data for the production of Management Information and returns to Lloyd's and other appropriate external regulatory and accounting returns. This programme should include:

- Data validation & consistency;
- Data completeness;
- Effectiveness of analysis procedures;
- Process of converting data to Management Information;
- Effectiveness of reporting to Lloyd's; and
- Reporting accuracy / completeness / timeliness.