LLOYD'S MINIMUM STANDARDS

MS9 - RESERVING

OCTOBER 2015

MS9 - RESERVING

MINIMUM STANDARDS AND REQUIREMENTS

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

Within this document the standards and supporting requirements (the "must dos" to meet the standard) 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. They are 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 the Requirements to meet the Minimum Standards.

DEFINITIONS

AFR - Actuarial Function Report

GQD - Gross Quarterly Data

MI - Management Information

MRC - Market Reserving and Capital team at Lloyd's

NEDs - Non-Executive Directors

ORSA - Own Risk and Solvency Assessment.

QMC - Quarterly Monitoring Return Part C

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;*
- *provide objective challenge to the recommendations made by the reserving function; and*
- *ensure there are consistency and links between reserving, pricing, capital modelling and financial reporting.*

Reserving is the responsibility of the managing agent's 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 onus on the board to give due consideration to the reserve decisions and to be ultimately responsible for the result. The board should allocate sufficient time to consider reserves themselves, and must provide an objective challenge to the proposals brought to them. 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 asking for board minutes, Lloyd's may request access to independent non-executive directors (NEDs).

Lloyd's would expect the audit committee and internal audit to review the reserving process periodically and may ask for copies of their reviews, to know what information they were given, and possibly for access to them.

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. Boards should be aware of relevant actuarial standards.

The reserving process must be consistent with the treatment of reserve risk in the capital model. The duty to demonstrate consistency between the setting and modelling of reserves lies with the risk management function but the reserving function should contribute to that process. It should also be ensured that there are links between the reserving and pricing functions and consistency with financial reporting.

SECTION 2: STATEMENT OF ACTUARIAL OPINION

RS 2.1

Statement of Actuarial Opinion

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

Managing agents shall ensure that:

- *the SAO complies with Lloyd's Valuation of Liabilities rules;*
- *an SAO is provided annually in respect of each open year of a syndicate;*
- *the SAO results are considered by the Board; and*
- *there is an appropriate relationship between reserve margins signed off in the SAO and those reported to Lloyd's in the QMC.*

Currently 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. This includes holding a relevant practicing certificate issued by the actuarial profession. The latest criteria including qualifications for practicing certificate actuaries are described on the actuarial profession's website and include requirements that the actuary is qualified in the UK (or holds an equivalent qualification) and has recent experience in relevant areas. SAO actuaries may be employed by the agent or be external consultants.

The SAO must comply with the Valuation of Liabilities Rules issued by Lloyd's. The SAO system is under review with the introduction of Solvency II, and any changes will be flagged in good time.

Since Lloyd's has been providing feedback on the SAO reports the standards have improved and are now all rated good or better. Due to continued improvement in standards Lloyd's will now only formally review one third of its' SAO reports every year over the next three years. This has been communicated with the market. The review of each report has regard to the relevant technical actuarial standards; Lloyd's provides feedback to the producers whose reports are formally reviewed.

Lloyd's will also use the SAO reports to validate reserve margins reported by managing agents in the QMC. Managing agents should ensure that margins reported in the QMC are not larger than those signed off in the SAO. Lloyd's will question syndicates where the QMC margin is larger than that in the SAO and capital loadings will be applied if suitable explanation is not provided.

Managing agents and signing actuaries (or their firms) should consider the merits of rotation of the SAO actuary periodically, and document the rationale if the same individual provider continues to sign the SAO for more than four consecutive years.

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. In particular:

- *ensuring the use of appropriate methods and assumptions;*
- *ensuring the accuracy, completeness and appropriateness of data for use;*
- *undertaking an analysis of actual versus expected experience as well as other appropriate validations; and*
- *producing a report at least annually to the board ('The Actuarial Function Report') 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. As Lloyd's ensures managing agents operate at Solvency II equivalent standards, these requirements extend to agents in their management of syndicates.

Managing agents will have in place Syndicate Actuarial Functions (SAFs). The function should consist of individuals suitably knowledgeable and experienced to conduct the role. They may be provided by resource internal or external to the managing agent but should be familiar with the managing agent's business and the risks it faces.

Lloyd's has set out its requirements and expectations for SAFs; the latest position is provided on the Lloyd's website.

In addition to the above requirements of SAFs in respect of technical provisions, SAFs are also expected to:

- produce opinions on the underwriting policy and reinsurance arrangements in respect of their managed syndicates; and
- report on how they have contributed to the risk management system, with particular regard to the ORSA and internal model.

These additional requirements should be captured in the annual reporting of SAFs but need not be at the same time as the technical provision reporting. For example, SAFs may wish to provide their opinion on the underwriting policy during the business planning process for the coming underwriting year.

To fulfil its market oversight duties, Lloyd's will collect all SAF reports for review annually.

SECTION 4: BOARD INFORMATION

RS 4.1

Board Information

Managing agents shall ensure that sufficient information is supplied to the Board on reserves.

Managing agents shall ensure that information provided to the Board:

- *is accurate;*
- *is sufficient for challenge to be made;*
- *is accompanied by analysis from the reserving function;*
- *includes escalation of relevant information provided by Lloyd's; and*
- *includes discussion of key issues, uncertainties and market conditions.*

In order for the board to reach their own conclusions on reserves and provide the necessary objective challenge they should be provided with appropriate management information (MI). The MI should be sufficient and sufficiently accurate to support these important decisions.

The MI should cover the syndicate's own experience and also information on market conditions. Relatively high risk areas should be covered in more detail. Examples of high risk include: large accounts, lines of business with greater inherent uncertainty, new lines, accounts with higher claims than usual or than expected, lines where there has been a deterioration since the previous reserve analysis and lines with special reinsurance characteristics such as a risk of exhaustion. This list is not exhaustive.

The information on market conditions is important because reserves set at times of weak market conditions for underwriting have historically been seen to be more prone to deterioration than those set at stronger points in the cycle. The board should be aware of this cycle feature and its deliberations should include the impact of the cycle where this is relevant.

The MI should be accompanied by analysis from the reserving function – whether actuaries or not – and this report should be fit for purpose. The analysis should include emerging experience and movements in the period on reserves previously set.

MI should consider claims and reserves gross and net of reinsurance, with detailed analysis relating to outward reinsurance where it is a material issue.

Claims information, including for example narrative regarding large claims and information on material actual or potential reinsurance disputes, is a normal component of reserving MI.

If an external actuary has recommended reserves, for example through the SAO process at year end, the board should consider the external actuary's analysis and the external actuary should normally present this in person. A good practice is for non-executive directors to meet the external actuary without the executive board members in attendance.

Lloyd's may ask for MI, but will endeavour to restrict this to material that has already been prepared. The board should be aware of any benchmark or similar feedback information relevant to reserving provided to the syndicate by Lloyd's and the board is responsible for responding to concerns raised by Lloyd's.

Lloyd's oversight of reserves includes regular reviews and analyses such as the reserve benchmarking exercise. Lloyd's will actively engage with syndicates in the market and will provide regular communications on reserving topics. Information provided by Lloyd’s should be escalated to the board where relevant.

Lloyd’s feedback includes:

- annual reserve benchmarking packs;
- requirements such as contained in the Lloyd’s Valuation of Liabilities Rules;
- specific and market wide feedback and commentary; and
- feedback to SAO and AFR providers.

Lloyd’s may comment on the quality and completeness of information provided to boards where appropriate.

Lloyd’s also provides several overseas regulators with information on the reserving requirements associated with situs funds, and will communicate with agents about their exposures in territories for which funds are required.

Lloyd’s will also look to agents to help keep information up to date on reserving themes that agents are much closer to, and where possible, will feed back on wider or thematic reserving issues.

Engagement with Lloyd’s should not be seen as prima facie evidence of perceived reserving issues as it is a normal part of Lloyd’s reserve oversight and should be expected.

SECTION 5: RESERVING PROCEDURE

RS 5.1

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; and*
- *internal audit periodically review reserving processes including validation of methods and results.*

Whether the formal SAO work is done internally or by an external actuarial firm, the managing agent should have their own technical reserving team. This does not have to be staffed by actuaries, but typically it will be and the team must have appropriate skills. The reserving team should produce recommendations on reserves supported by argument and analysis, and these should be compared against other views, for example from claims and underwriting staff. In some cases, the reserving team may review or produce a parallel run to the reserves produced by others, such as underwriters, with both feeding into the decision making process.

There is no prescribed or required structure for the validation of the reserves. The board must take its own view having considered the various views, including the process for validation of the reserves. It is expected that the reserving process, methods and results will be subject to a periodic review from the managing agent's internal audit function.

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

Usually ,several methods for estimating liabilities will be considered and the final choices must be justified clearly with reasons and limitations set out. The methods used by the technical reserving team should be properly validated especially when they depart from the methods normally used, and the results too should be carefully analysed for reasonableness. In particular, Lloyd's attaches considerable weight to analyses of emerging experience against the expectation contained in previous analyses. Where experience is worse than predicted, the reasons need to be identified and understood and if it is material or part of a trend there is a strong prima facie argument that reserves should be strengthened. Lloyd's is likely to ask to see analyses of emerging experience as a first step in any more detailed review.

The technical reserving team will be expected to know the relevant 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. Lloyd's will engage directly with the reserving team and will take the head of that team to be the first point of contact on reserving matters. Lloyd's will provide feedback to the team, and benchmarking information will be supplied.

In view of the importance of syndicate technical reserving teams to Lloyd's oversight of the market's reserve strength, Lloyd's would expect any prospective change in the leadership of the team to be flagged to Lloyd's as early as possible. Lloyd's would normally expect to meet a new head of reserving or chief actuary when they were appointed for an informal introduction and may require the opportunity to review such senior appointments before they are confirmed.

Where Lloyd's perceives that a syndicate may have an inadequate reserving process or practice then Lloyd's may impose some requirements on the syndicate such as explicit capital loads or more stringent reporting.

The reserves are set by the board of the managing agent. If Lloyd's believes there is an unduly high risk that these reserves will prove inadequate, Lloyd's will engage closely with the agent.

Initially when there are concerns, Lloyd's will ask to meet the main protagonists at the agent – the chief actuary or head of reserving, and if necessary the finance director or chief executive. As noted this will involve review of internal MI and documentation to help assess the position, and Lloyd's may require specific extra analyses although will endeavour not to do this; good internal MI should be sufficient for our purposes. It is expected that staff and materials will be made available in a timely manner and access granted to external advisers where appropriate.

If the issue is not immediately resolved, then usually a quarterly meeting will be set up to dovetail with the quarterly reserving 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 springboard 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 will wish to understand and potentially influence the thinking of the head of reserving in good time, often before the quarter's reserves are finalised.

Lloyd's will endeavour to resolve all issues, but exceptionally may require an agent to have an (additional) external review carried out.

Lloyd's will identify syndicates of concern through benchmarking, observation of trends, the exposure of syndicates to thematic issues, for example by line of business, or by perceived issues in syndicate processes such as those indicated by inability to supply adequate and accurate data. A "very prudent" reserve with a poor process would still be a concern.

Concerns about reserving will be fed into the capital review process, and may lead to Lloyd's making adjustments to solvency reserves or to loss ratios assumed in the capital model, or to explicit loadings in capital required.

Ultimately Lloyd's can require a loading to be applied to the solvency reserves of the syndicate. However this option would not be exercised until all avenues had been explored.

SECTION 6: DOCUMENTATION

RS 6.1

Documentation

Managing agents shall have an appropriately documented reserving process.

Managing agents shall ensure that the documentation of the reserving process is completed in accordance with the Technical Actuarial Standards.

The documentation should enable boards and any reviewers to assess the reserves. It should contain an analysis and an estimate of reserve uncertainty, and explanations of the methods used especially where these are non-standard. The judgements should be identifiable and should be justified.

There must be appropriate disclosure to auditors and SAO-signing actuaries and the documentation should show what has been disclosed and how. Lloyd's may ask to see this.

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. Lloyd's will have regard to relevant actuarial standards as part of the review process.

A syndicate SAO actuary must provide a formal actuarial report in support of the SAO. Lloyd's will review these reports and feed back to the providers and may ask for internal documents for review as well.

Under Solvency II, actuarial functions must provide a formal report to the board and Lloyd's review these reports in a similar fashion.

SECTION 7: RESERVING DATA

RS 7.1

Data

The managing agent shall ensure that reserving data submissions to Lloyd's are appropriate.

The managing agent shall ensure that the reserving data is:

- *reported through the Technical Provisions Data (TPD) and Gross Quarterly Data (GQD) in accordance with current instructions;*
- *reconciles to the syndicate accounts (where required); and*
- *is reported at the required level of granularity.*

A proper reserving analysis requires a range of data inputs, and these must be of good quality and appropriate for the task. Any data issues or changes to processes which may impact reserving, such as claims handling, should be brought to the attention of the board. Data management is often a separate responsibility and it is expected good practice that there is a clearly identified owner of the data used. The technical reserving team should have a strong input into what is collected and how it is stored, and should review the data carefully before relying on it.

The grouping of data should be suitable to the portfolio, taking account of the requirements of homogeneity and credibility of data. As a minimum, the reserves must be able to be stated in the categories required by Lloyd's by class and currency. The Technical Provisions Data (TPD) annual return is of great importance to Lloyd's and must reconcile with both the audited annual returns and the reserve analyses. The Gross Quarterly Data (GQD) is used by Lloyd's for interim monitoring and data provided must comply with current instructions. Lloyd's will examine submissions carefully, challenging any apparent inconsistencies.

There should be a clear reconciliation, which Lloyd's may ask to see, between the reserves on all the bases used by the agent – these are likely to include at least solvency, business planning and financial accounting bases.

Under Solvency II the actuarial function will be required to assess data for completeness, accuracy and appropriateness.