Underwriting and Controls – Better Wordings Matter
Jon Hancock, Director, Performance Management
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11th Floor, Lloyd's

Key themes

- *Wordings are a key focus of underwriting performance oversight - underline the importance robust review of underwriting controls*
- *The market has lost its focus on contract certainty, a view informed by discussion with agents, and other thematic reviews.*
- *Leakage of £500m plus on claims disputes, legal fees and unplanned claims payments has been estimated to be occurring each year currently from the market.*
- *There is a wordings talent shortage in the market, and the talent pipeline is severely lacking.*

Thank you, Mark.

Good morning everyone,

Thanks for coming along today.

This is your first Lloyd's Wordings conference for 14 months . . . it's my first Lloyd's one ever!

And it may be that seeing the words "Wordings conference" in your diary this morning might not have you bounding out of bed with enthusiasm for the day ahead!

But it should have done!!

Because while they may not set everyone's pulse racing, wordings and contract certainty are a critical part of underwriting control. This today is more important than ever.

We all remember how critical the policy wording was when Larry Silverstein, the owner of the World Trade Centre, made a $7 billion claim after the 9/11 attacks based on it being two events not one. When the court ruled it was in fact one event, **based on the wording**, the claim was effectively cut in half to $3.5 billion for Lloyd's and the seven other insurers who brought the case.

And more recently, Amtrak attempted to claim an estimated $1.1 billion of losses from Superstorm Sandy. In this case too, the judge ruled the event was a single occurrence significantly reducing the amount of claims the market had to pay.

The amount the market was **supposed** to pay.

"Wordings" are much more than words. They can be the difference in billions of dollars in claims. They are **the** critical factor that could mean you can pay the claim, or you can't and go bust. Or a policyholder goes bust.

So in this context, wordings and contract certainty do **get my pulse racing!**

These sorts of stories are the reason I share the views of my predecessors that Wordings oversight is one of our really critical roles in Performance Management.

And while Lloyd's has improved wordings over the last few years, I think the market has lost **some** of its focus on **contract certainty –** you'll hear a different view shortly from John – that's OK, I believe contract quality has suffered as a result and has **sometimes** become a bit of a tick-box exercise: while the heading might be there, what about the **actual** content of the clause? What is the quality of the wording like? Is it a Wording you understand? Or want?

Last year we carried out a number of reviews and interviews with managing agents that gave me some idea of how far things have slipped.

My colleague Mark Williams will go into more detail on these findings later but some of the headlines make for uncomfortable reading.

In that survey:

- We found that more than half of managing agents in a follow position do not carry out pre-bind checks, even on a risk-based approach. This means that only about a third of followers' gross written premium is being checked by managing agents.

- a significant number of managing agents don't report on contract wordings to senior management.

- We estimate that disputed claims, including legal fees and unplanned claims payments as a result of inaccurate wordings are costing the market about £500m annually.

- And this exacerbated by the fact we're facing a **wordings talent** shortage. We found that more than 60% of managing agents employ less than five wordings experts.

And I think there are a number of reasons for this slippage.

It's a buyers' market right now, we all know that. Clients and brokers, knowing they're in a strong position, are asking for wordings to be changed to include additional cover. And followers aren't checking the contracts because they can't have much of an impact. If they do challenge, the threat is always that brokers will go elsewhere.

I've even heard people talk about the end of the subscription market because, they say, you should be able to rely on the leader to do the pre-bind check and review of the slip and wordings.

If you are a follower, we still advocate taking a risk-based approach to full review of slips and wordings, even if you can't affect the outcome, because at least you're entering a contract with your eyes wide open. But not everyone is doing this.

The increasing use of broker facilities means that more and more brokers are writing their own wordings. Not only is this extra work for the carriers who have to check multiple contracts instead of the one they issue, it can also lead to the intent behind the words getting lost. That's not to say that new wordings are a bad thing – they're often really positive. But there does need to be certainty around what is and isn't being included.

And the fact there are less wordings experts around means there is less of a safety net to catch loose terms and conditions that may create problems further down the line. While wordings experts are more highly valued than they were, there is still a view that their work should be mainly post-bind, when it really should be pre-bind.

It's obviously important that we get control of wordings from a cost point of view, especially given the need to cut expenses in these tough market conditions. That half a billion pounds on costs generated by wordings disputes and associated fees cannot be acceptable.

Compliance is evolving. Just over a year ago, the PRA wrote to all CEOs setting out the importance of underwriting controls as the first line of defence in identifying the extent and potential impact of the soft market. They made specific reference to the Board's duty in understanding exposure, pricing and terms and conditions changes. So we have a very clear responsibility there.

The Insurance Act that came into force in August last year and, with its impact on the meaning of warranties and conditions and claims payment deadlines, extra vigilance on wordings is more important than ever.

And of course everyone has responsibilities under Lloyd's Minimum standards, which set out how we expect managing agents to approach review and agreement of wordings, with three requirements that relate specifically to wordings.

The Conduct Minimum Standards are also helping improve contract certainty by focusing on the oversight of the wordings around high-risk products, through product oversight groups.

So what is my Performance Management team doing to improve contract Wordings?

First, this year we are investing in the Contract Quality Triage Tool – software that will help underwriters to robustly review wordings pre-bind. This will be a useful way to supplement existing checks and potentially provide syndicates with a way to manage the perceived risks.

There are multiple benefits to managing agents. These include:

- Reduced claims disputes from ambiguous wordings/unexpected exposures
- Reduced operational risk capital allocation for poor quality wordings
- Improved underwriting by helping you to factor wordings terms and conditions into pricing and risk selection.

- and improved regulatory compliance.

You'll see a short video on CQT tool later.

Second, we will be carrying out our annual refresh of Lloyd's Minimum Underwriting Standards. This year we will be focusing on clarifying and enhancing the requirements on a number of areas including:

- Underwriting guidelines and/or authorities in relation to review and agreement of slips and wordings.

- Pre-bind quality assurance on a lead and follow basis.

- Terms of reference and reporting for peer and independent review to include specific reference to and commentary on wordings/PBQA review processes, the key changes to terms and conditions in slips and wordings, and the impact on any disputed claims.

Third, we will continue to work with the LMA and other market bodies on initiatives to address the wordings talent gap. This year's graduate intake at Lloyd's will include a grad that'll focus solely on wordings. There's a panel later in the day looking at the talent gap in more detail.

[CONCLUSION]

So as you have heard, wordings have been a focus for my team over the last year and will continue to be a priority for us.

But as well as the practical work we are doing to improve contract certainty, we need to make sure we all keep talking about wordings. We talk about rates al the time – but wordings barely get a mention. That's pretty odd when you think about it because rates don't **obviously** cost you $500m in unwelcome surprises - sloppy wordings can do.

That's why this conference is so important.

So thank you again for attending today – and showing that Wordings' are front of mind for you too.

Thank you.