Market Bulletin

LLOYD'S

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FROM:	Franchise Performance Director
LOCATION:	86/GY5
EXTENSION:	6743
DATE:	21 May 2004
REFERENCE:	Y3318
SUBJECT:	MONITORING PRICING MOVEMENTS AND ASSESSING THE IMPACT ON LOSS RATIOS
ATTACHMENTS:	2 Appendices
ACTION POINTS:	Managing agents to note: 1) FPD's view of the essential characteristics of an effective process 2) they are expected to implement an effective process 3) they will be asked to demonstrate their process as it is regarded by FPD to be an important factor in the assessment of their syndicates' business plans

Many managing agents utilise processes which (a) monitor pricing movements (b) assess the impact that such pricing movements may have on a syndicate's loss ratios and (c) provide for that information to be used when the managing agent formulates, reviews and amends a syndicate's business plan.

The use of such a monitoring and assessment process represents sound business practice which enables managing agents to manage syndicates in a well informed and prudent manner. Accordingly, the Franchise Performance Directorate (FPD) considers that such a practice should be applied by each managing agent in order to promote high underwriting standards throughout the Lloyd's market and thereby assist the market to achieve consistent underwriting profits.

The purpose of this bulletin is therefore three-fold –

- to set out FPD's view of the essential characteristics of an effective monitoring and assessment process;

- to advise managing agents that they are expected to utilise an effective monitoring and assessment process;
- to advise managing agents that they will be asked to demonstrate the effectiveness of their monitoring and assessment process as it will be an important factor in the assessment of their syndicates' business plans.

FPD recognises that, currently, not all managing agents utilise a fully effective monitoring and assessment process. Those that do not are requested to call their usual contact within FPD so that we can discuss the situation with you and work towards a solution.

An effective process

Each managing agent is best placed to determine and implement a monitoring and assessment process which reflects its business needs and processes. However, FPD considers that all monitoring and assessment processes should have the following characteristics and features if they are to be effective –

- the process monitors, on a risk by risk basis, the difference between the actual price charged for a risk against the technical price and, in respect of renewal business, pricing movements from the previous year;
- all aspects of pricing movements are taken into account and recorded separately. Pricing movements include rate changes, how rates are applied to the underlying risk exposure, variations in attachment points and deductibles, changes to coverage and terms and conditions and, where relevant, the provision made for claims inflation;
- the process monitors risks which have not been renewed;
- the process includes detailed written guidance for underwriters setting out how they are to record and quantify pricing movements so as to ensure consistency of approach between underwriters;
- information recorded by underwriters is subject to regular internal reviews and checks to ensure that input data is accurate, consistent and reliable;
- the process identifies who is responsible for assessing and calculating the impact that pricing movements, new business and business which has not been renewed may have on the syndicate's loss ratios;
- the process also sets out how the managing agent's board will use the above information when it formulates reviews and amends a syndicate's business plan.

Overall, an effective monitoring and assessment process should enable a managing agent to –

- obtain a more accurate insight into the current pricing environment;
- better review and monitor the business which a syndicate has underwritten;
- implement better controls over the business which its syndicates intend to underwrite and instil appropriate underwriter disciplines;
- review its syndicates underwriting strategies and make more timely adjustments to the business plans in response to the underwriting cycle;
- allow for better reserving.

Two diagrams are shown in appendices 1 and 2. Appendix 1 illustrates at a portfolio level the effect on the loss ratio of pricing movements and claims inflation on renewals, the effect on the loss ratio of not renewing business and the effect on the loss ratio of writing new

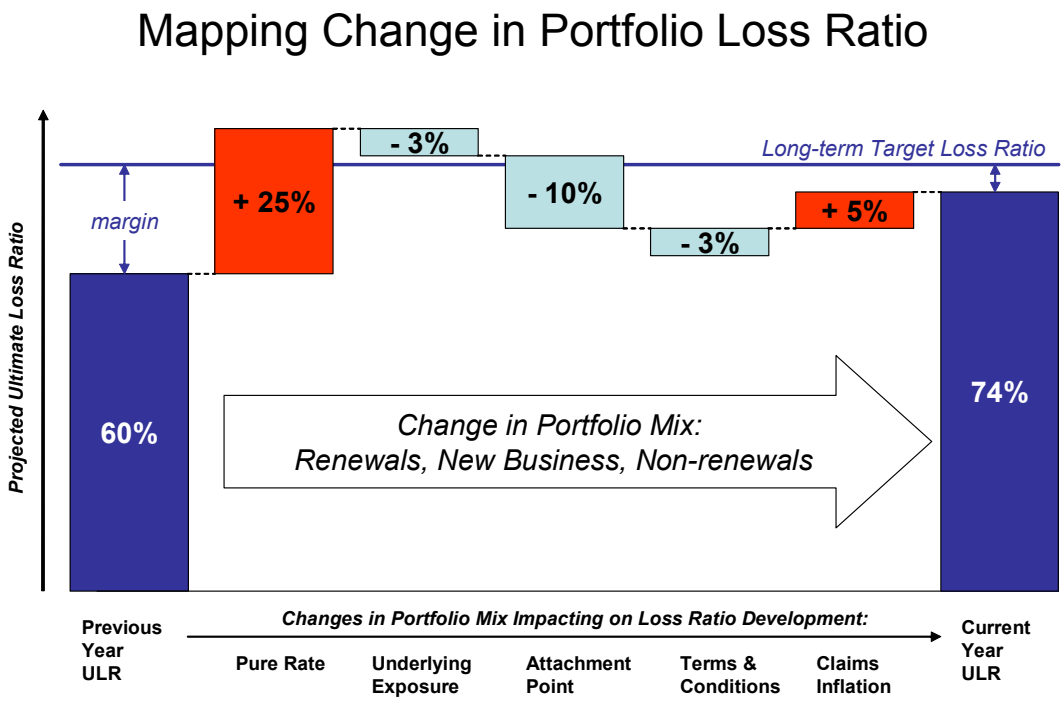
business. Appendix 2 illustrates the principle of isolating pure rate change from other pricing factors for a renewal as this component is sometimes hidden in the process. Appendix 2 is simply designed to emphasise the importance of understanding what is meant by pure rate change.

Demonstrating an effective process – the next steps

FPD will be reviewing managing agents' monitoring and assessment processes during the business plan approval process. Your FPD contact will be in touch with you shortly if they have not done so already to make the necessary arrangements. FPD recognise that not all processes will currently have all of the above characteristics and features. However, FPD is committed to working with managing agents where necessary to improve managing agents monitoring and assessment processes so as to promote high standards in this area throughout the market.

This bulletin had been sent to all managing agents, active underwriters and Lloyd's Market Associations.

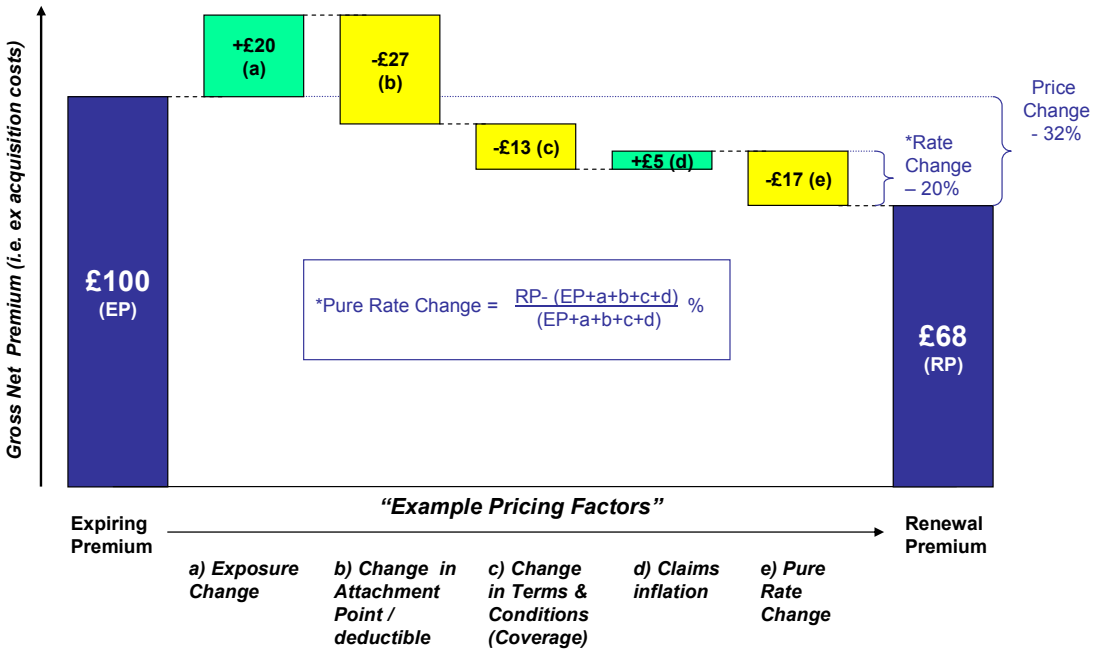
Appendix 1


Mapping Change in Portfolio Loss Ratio
Projected Ultimate Loss Ratio
margin
60%
+ 25%
- 3%
- 10%
- 3%
+ 5%
Long-term Target Loss Ratio
74%
Change in Portfolio Mix:
Renewals, New Business, Non-renewals
Previous Year ULR
Changes in Portfolio Mix Impacting on Loss Ratio Development:
Pure Rate
Underlying Exposure
Attachment Point
Terms & Conditions
Claims Inflation
Current Year ULR

Appendix 2

This illustration is intended to provide a simple example of how "pure rate change" could be isolated from other pricing factors. By isolating rate change it should be possible to gain a more accurate insight into the current pricing environment and trends that will in turn inform business planning.

Identifying "Pure Rate Change" for an Individual Renewal



In the example above, the price has been adjusted by the underwriter to reflect changes in the following factors:

a) An increase in premium to reflect the change in exposure / the values at risk
b) The attachment point / deductible has been increased allowing a reduction in premium
c) Policy terms and conditions have been altered [restricting cover] allowing a reduction in premium
d) The premium has been raised to reflect the adverse effect of claims inflation
e) The pure rate change reflects the rating movement after all other effects have been allowed for. In this example the renewal premium would have been £85 (EP+a+b+c+d) before any pure rate change.