LLOYD'S

MARKET BULLETIN

REF: Y4015

Title	Lloyd's Underwriting Management Standards: Pre-Bind Quality Assurance (PBQA)
Purpose	To confirm expectations regarding Managing Agents' procedures for Pre-Bind Quality Assurance, and to provide guidance on the management of associated risks.
Type	Event
From	Rolf Tolle, Franchise Performance Director Contact details: 020 7327 6743 Rolf.Tolle@Lloyds.com
Date	10 May 2007
Deadline	In order that PBQA-associated risks are assessed and effectively managed, Managing Agents are requested to review their current procedures and revise them where necessary by 1 July 2007. This Bulletin should be read by Compliance, Risk and Underwriting leaders in each Managing Agent.
Related Documents	- Market Bulletin Y3844 (Lloyd's Underwriting Management Standards) - LMA Bulletin (LMA07-012-MR)

Background to Pre-Bind Quality Assurance
Within the Lloyd's Underwriting Management Standards, published on 6 July 2006, Principles 2 and 3 included the expectation that Contract Certainty (CC) requirements will be met. The market has responded to the CC challenge with results reported ahead of target. Changes confirmed by the LMA in their Bulletin dated 23 February relating to the nature and timing of slip checking have now underlined the new reality ie that Managing Agents, as leaders or followers, need to assess the completeness and quality of contracts before they are entered into. This assessment should include Contract Certainty, Tax & Regulatory and Lloyd's Advisory & Risk Management aspects. Consequently, within the Underwriting Standards framework we are setting out requirements for all in the Lloyd's market regarding PBQA procedures and providing guidance which we hope will be of assistance to Managing Agents.

Current market procedures
The 'fact find' exercise, now completed, has revealed a range of approaches and procedures. Many Managing Agents welcome greater clarity as to expectations regarding

PBQA, as well as advice & guidance. There is general agreement that PBQA procedures can and will vary, even within a Managing Agent's organisation, as long as this is reflecting an effective risk-based approach. These procedures are likely to depend upon experienced personnel using appropriate tools and service providers as necessary, including the QA Tool, which should not be regarded as the complete solution.

Lloyd's established a working group with membership from a range of managing agents to review how best to respond to these changing circumstances. Feedback from this group reflects the market's preference for requirements that do not duplicate the Underwriting Standards already in place and for guidance that is not prescriptive ie leaving Managing Agents to assess their own risk and put in place appropriate procedures. Additionally, PBQA should focus upon the Managing Agent's procedures relating to slip formation and checking and not the commercial issues relating to business being underwritten, which is entirely accepted.

One issue that needs to be addressed is how followers should be assessing quality. While there is no expectation that followers will be replicating all checks made by the Lloyd's leader, followers will need to reassure themselves that appropriate assessment of quality has been undertaken. Leaders can expect that followers may well be asking them to confirm their PBQA procedures.

Extending the Lloyd's Underwriting Management Standards
Within the attachment to this note the current Underwriting Standards have been extended to reflect the position from 1 July, although with at least half of slips currently not being sent to XIS for issue of a Lloyd's Policy, Managing Agents already have significant exposure to manage regarding the quality of contracts being entered into. Each Managing Agent is requested to review its current position and to take steps to ensure that PBQA procedures, reflecting the nature of its portfolio, are in place by 1 July 2007.

Assistance with Tax and Regulatory details pre-bind
It is recognised that there are particular concerns regarding the responsibility for the accuracy of tax-related details pre-bind and the intention is to assist underwriting personnel as necessary. Contracts also need to comply with all applicable regulatory requirements. In addition to the Tax and Regulatory checks in the QA Tool, the Lloyd's market also has access to further taxation and regulatory details via a new business tool called 'Crystal' www.lloyds.com/crystal.

If these sources do not provide the required answers Managing Agents can contact the Lloyd's Taxation team or Lloyd's International Trading Advice. Alternatively, there are external checking service provider options.

PBQA & Delegated Underwriting
The scope for this review has been primarily Open Market and Treaty business. Enquiries have also been made of the LMA Delegated Underwriting Committee, recognising that considerable progress has already been made to embed common standards for the management of firms with delegated underwriting authority, including the required content and despatch of insurance documents. An aspect requiring attention is the expectation that coverholders will confirm their timely despatch of certificates, so that Managing Agents can

demonstrate their compliance regarding Contract Certainty. The LMA Delegated Underwriting Committee supports the minimum standard on page 9 of the revised Underwriting Standards extract enclosed and Managing Agents should note the guidance regarding demonstration of this standard (on page 13 of the attached extract), which has also been reviewed with the LMBC Bolt Committee.

Information via Lloyds.com
All information regarding PBQA-related services and contacts is being made readily accessible via Lloyds.com. As well as the QA Tools, a range of information is available and will be regularly updated including background to this change, additional services, useful contacts and answers to 'frequently asked questions'.
www.lloyds.com/Lloyds_Market/Performance_management_framework

Enquiries
Any enquiries relating to this Bulletin can be directed to myself, or to Kieran Flynn, Franchise Performance (020 7327 5739 Kieran.Flynn@Lloyds.com), or to Olly Reeves, Risk Management (020 7327 6229 Olly.Reeves@Lloyds.com) who have been working with the market on this issue.

Franchise Performance Director

APPENDIX TO MARKET BULLETIN Y4015
UPDATING PRINCIPLES 2 AND 3
REGARDING PRE-BIND QUALITY ASSURANCE

LLOYD'S

UNDERWRITING MANAGEMENT

THE FRANCHISEE EFFECTIVELY MANAGES ITS UNDERWRITING IN SUPPORT OF ITS BUSINESS STRATEGY

Responsibility for meeting the Lloyd's Underwriting Principles and Minimum Standards rests with each franchisee's board, whether their underwriting is undertaken in house, whether any underwriting authority is delegated to third party(s), or whether underwriting-related services are procured externally.

PRINCIPLES

1 UNDERWRITING STRATEGY AND PLANNING

The franchisee has an effective process for challenging the annual business plan which itself forms part of the long-term plan for each managed syndicate

2 UNDERWRITING AND CONTROLS

The franchisee has effective systems and controls over each managed syndicate's underwriting

3 DELEGATED AUTHORITY

The franchisee has effective systems and controls wherever underwriting authority has been delegated to another entity

4 PRICING AND RATE MONITORING

The franchisee has appropriate pricing methodologies and effective rate monitoring processes

5 EXPOSURE MANAGEMENT AND ASSESSMENT

The franchisee has effective systems and processes to record, monitor and assess its underwriting exposures

6 REINSURANCE

The franchisee has effective controls over its outwards reinsurance arrangements

7 DATA QUALITY

There are effective systems for the recording and reporting of underwriting-related data to management and the franchisor

UNDERWRITING MANAGEMENT

2 UNDERWRITING AND CONTROLS

PRINCIPLE

The franchisee has effective systems and controls over each managed syndicate's underwriting

MINIMUM STANDARDS

The franchisee's board should ensure that there are effective underwriting systems and controls in place.

Effective systems and controls have the following features:

- they ensure that underwriting takes into account:
  - the syndicate's annual business plan and underwriting policy
  - the underwriter's terms of reference and authorities pricing policy
  - exposure management information
  - the syndicate's reinsurance arrangements
  - **requirements to achieve Pre-Bind Quality Assurance (PBQA), including Contract Certainty**
  - external regulatory requirements

- they ensure that the franchisee keeps (or has the right to access) all relevant information in respect of each risk underwritten by the syndicate including the slip and the placing documentation

- they ensure that a representative range of risks underwritten by the syndicate is reviewed and assessed regularly by an appropriately qualified individual who is independent of the underwriter of those risks

- they ensure that underwriting decisions are the subject of an appropriate peer review process

- they require the referral of risks or underwriting decisions which are outside an underwriter's agreed levels of authority

UNDERWRITING MANAGEMENT

1 UNDERWRITING STRATEGY AND PLANNING

2 UNDERWRITING AND CONTROLS

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- pricing policy
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- the syndicate's reinsurance arrangements
- the requirements for contract certainty
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GUIDANCE

2 UNDERWRITING AND CONTROLS

<u>Effective systems and controls - Overview</u>

Effective systems and controls are essential for the delivery of the franchisee's strategic and business plans. To facilitate this it is expected that the franchisee's board will nominate one director to be responsible for the franchisee's underwriting systems and controls and ensure that the nominated director and supporting staff have the requisite skills, experience and available time to manage and execute the controls effectively.

Reference to 'Effective systems and controls' should be interpreted as widely as necessary for the effective management of each syndicate. Controls are seen broadly to sit under two headings:

- Prevention controls - These include, for example, written authorisation and proactive management of each individual's underwriting authority and the proactive management of any variances to prescribed procedures/ authorities.

- Detection controls - These include, for example, internal audit reviews, peer review processes and independent reviews.

Franchisees' controls would normally reflect the levels of value and the degree of risk within their underwriting activities.

It is expected that franchisees will have their systems and controls for the effective management of each syndicate set out in writing.

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Syndicate's annual business plan and underwriting policy

The franchisee's underwriting controls will ensure that underwriting is aligned with their strategy, approved business plan and underwriting policy. The underwriting policy will typically contain the following elements:

- each syndicate's line guide details by class of business
- a process for authorising material deviations from the business plan or line guide requirements
- each syndicate's approach to fronting business for other insurers
- each syndicate's approach to ensuring that Contract Certainty is achieved

Franchisees are expected to have controls in place to ensure that regulatory requirements and the scope of Lloyd's market licences are clearly understood and that risks are written within those requirements.

The underwriter's terms of reference and authorities

It is expected that each underwriter's terms of reference and authority should be written, properly authorised and reviewed annually to reflect his/her experience and knowledge and to ensure alignment with the business plan (It would be good practice for each underwriter to signify agreement by signing his/ her authority details).

Pricing Policy

Franchisees need to have a clear expectation of pricing levels and an audit trail to show how pricing will deliver the projected results within the approved business plan and how pricing will be managed over the relevant underwriting cycle.

Exposure Management Information

The franchisee's underwriting controls are expected to ensure that underwriting activities take account of their updated aggregate exposure management and assessment information and that:

- aggregates are managed within the parameters of the approved business plan
- appropriate reinsurance coverage is in place

UNDERWRITING MANAGEMENT

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Retention of all relevant information

Each franchisee is expected to be able to produce all relevant information regarding each risk written to satisfy audit purposes and to allow the proactive review and management of each risk. Relevant information would include slips and placing information, as well as the rationale for risk acceptance, terms and pricing.

Testing of underwriting controls

Franchisees are expected to test that underwriting controls are working effectively and to produce written reports to demonstrate this at least quarterly, with any variances or control failures highlighted and addressed. The findings from control testing should be shared with relevant underwriting teams and actions relating to variances agreed. It is expected that the findings would also be shared with the franchisee's board. (Testing should ideally include consideration of reinsurance programmes, systems for modelling risks and aggregating exposures and the records supporting pricing).

These reports will normally be built up from the writing of each risk, to enable detailed analysis of identified issues.

Where underwriting authority is delegated and aggregated returns are received by the franchisee it is expected that data at individual risk level will be available to the franchisee to ensure that underwriting controls are working effectively.

UNDERWRITING MANAGEMENT

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An appropriate peer review process

The peer review process is expected to review and where necessary challenge individual underwriting decisions to ensure that the franchisee's underwriting policies have been followed and, where necessary, that prompt action to resolve any issues identified is undertaken, including escalation in accordance with the franchisee's required procedures.

GUIDANCE

2 UNDERWRITING AND CONTROLS

Pre-Bind Quality Assurance

In essence Pre-Bind Quality Assurance (PBQA) is the process which assesses contracts to ensure as far as can be foreseen that they will perform as all parties intend. This assessment will include Contract Certainty, Tax & Regulatory and Lloyd's Advisory & Risk Management aspects.

Features of an effective process are likely to include:

1) a risk based approach to the PBQA process taking into account:

- Class of business
- Size of line
- Brokers' wordings performance
- Type of wording – bespoke or complex/use of standard terms/ standard form
- Individual underwriter's knowledge and experience of the territories/ class of business / wordings experience
- Availability of specialist wordings/ legal knowledge of insurance contract law
- Assessment of the leader's capability, where following

This can be achieved by developing a matrix of these risk factors to identify which risks fall into high, medium and low risk groups with appropriate procedures developed for each category.

For higher risk business cases e.g. new business or large risks with bespoke wordings, or where there are concerns regarding the quality of the leader's procedures the process could feature:

- Encouragement of brokers to submit wordings early for assessment
- Use of specialist wordings/legal personnel with the appropriate skill, knowledge and experience
- Use of the LMA Wordings Repository, the Market Wordings Database and other commercial wordings products to support specialist knowledge
- Feed back to underwriters of issues/ problems arising
- Checks against Lloyd's QA Tool either internally or subcontracted to a third party supplier

For medium risk business e.g. renewal of large risks, or small risks with bespoke wordings, where underwriter has good knowledge of the territorial requirements the process might feature

- Use of commercial software products to compare wordings
- Development and use of standard wordings for each class of business (retaining these within the LMA Wordings Repository)
- Check against Lloyd's QA tool or other commercial products, whether conducted internally or subcontracted to a third party supplier

- Feed back to underwriters of issues/ problems arising

For low risk business e.g. renewal business written on predefined wordings where the underwriter has good knowledge/ experience of the class of business and territories

- Rely on the underwriter's knowledge and experience with peer review by personnel with required experience to validate the quality of the process

2**) Continuing assessment of the quality of slips, including wordings** undertaken through periodic peer review reporting to the appropriate governing body within the managing agent and feeding back to underwriters which includes:

- identification of claims issues arising from wordings e.g. coverage disputes
- identification of issues arising from lack of experience
- output from internal audit process
- customer complaints
- independent review of the quality of a sample of wordings with more risks drawn from the higher, then medium, risk categories
- an assessment/ vetting of the performance of leaders for each class of business against the in house PBQA procedures
- feed back from Lloyd's review process

3) PBQA procedures set out, with clear accountability for their operation and a review process to ensure that they remain appropriate to the managing agent's specific business requirements.

Further information on tools/ services and sources of assistance can be accessed via Lloyds.com

UNDERWRITING MANAGEMENT

3 DELEGATED AUTHORITY

PRINCIPLE

The franchisee has effective systems and controls wherever underwriting authority has been delegated to another entity

MINIMUM STANDARDS

Effective systems and controls have the following features:

- the franchisee has a clear strategy for writing and managing delegated underwriting business as part of its overall business plan.
- the franchisee carries out thorough due diligence of coverholders to which it proposes to delegate authority.
- the franchisee ensures that it has binding authorities in place with each coverholder to which it delegates authority clearly defining the conditions, scope and limits of that authority **and which comply with Contract Certainty requirements, including the requirement to demonstrate regularly that insurance documents have been issued within required timescales.**
- the franchisee proactively manages delegated underwriting contracts once incepted to ensure compliance with contract conditions.

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3 DELEGATED UNDERWRITING

Clear Strategy for Delegated Underwriting

- It is expected that franchisees would have written procedures, agreed at board level, for managing delegated underwriting contracts. These procedures should be applied consistently to all syndicates managed by the franchisee and regularly reviewed and updated.

- The competencies needed for managing delegated underwriting arrangements are different to those needed for other methods of acceptance. Franchisees will need to satisfy themselves that they have the controls and resources (both systems and individuals with suitable experience and skills) to enter into and manage delegated underwriting arrangements effectively, taking into account:
  - the number of coverholders;
  - the number of contracts which a syndicate leads or follows;
  - the extent of delegation;
  - the volume of income;
  - the classes of business;
  - the level of exposure (e.g. catastrophe exposure); and
  - the geographical distribution.

UNDERWRITING MANAGEMENT

1 **UNDERWRITING STRATEGY AND PLANNING**

2 **UNDERWRITING AND CONTROLS**

3 **DELEGATED AUTHORITY**

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<u>Lloyd's Approved Coverholders</u>

- For coverholders that require Lloyd's approval the lead franchisee will need to take into account, as a minimum, the information required to be provided in the Lloyd's coverholder application form when it conducts its own due diligence. In assessing a new coverholder the franchisee needs to consider the suitability criteria for a Lloyd's approved coverholder (see paragraph 6 of chapter 2 of the Underwriting Requirements), including:
    - the individuals authorised to enter into contracts of insurance, issue insurance documents and agree claims.
    - the coverholder's reputation and standing
    - the coverholder's ability to operate a binding authority.
    - the coverholder's financial standing
    - the coverholder's underwriting plan for any proposed binding authority which should be reviewed to ensure that it fits with the franchisee's strategy.
    - the ability of the coverholder to comply with all relevant insurance, fiscal and taxation laws and requirements in the jurisdiction in which it is domiciled, trades or provides services under the binding authority. Franchisees are recommended to liaise with the Lloyd's representative or Lloyd's Market Services to establish local requirements.
- Where franchisees wish to lead a new binding authority or take over the lead of an existing binding authority with an existing Lloyd's approved coverholder they are expected to undertake their own due diligence of that coverholder.
- Franchisees should ensure that, where the binding authority is arranged by a Lloyd's broker, the Lloyd's broker has the necessary resources to administer and service the binding authority effectively.
- Where a binding authority is not arranged through a Lloyd's broker then franchisees require prior Lloyd's approval to "deal direct". Franchisees should ensure that they have the controls and resources to carry out all aspects of

administering a binding authority that would normally be handled by the Lloyd's broker, including:

  - document production
  - premium and claims handling (including payment of local taxes)

  Franchisees should have adequate written procedures for these processes.

- Franchisees should ensure that only authorised personnel take the final decision on entering into a binding authority once all the procedures to assess the financial, compliance and underwriting issues of the coverholder have been completed.
- Franchisees considering a following role on a binding authority with a new coverholder need to satisfy themselves that the necessary due diligence has been undertaken and must make their own decision as to the suitability of the coverholder.

Restricted Coverholders

- Franchisees carrying out due diligence of restricted coverholders to whom they are considering delegating authority will need to adapt the above procedures in accordance with the level and type of delegation.

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1 UNDERWRITING STRATEGY AND PLANNING

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3 DELEGATED AUTHORITY

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- the franchisee ensures that it has binding authorities in place with each coverholder to which it delegates authority clearly defining the conditions, scope and limits of that authority and which comply with Contract Certainty requirements.
- the franchisee proactively manages delegated underwriting contracts once incepted to ensure compliance with contract conditions.

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3 DELEGATED UNDERWRITING

Clearly Defined Authority

- Franchisees should ensure that there is a clear, consistent and complete contract in place prior to inception of all binding authorities. The contract should comply with Contract Certainty and QA tool requirements and the relevant provisions included at paragraphs 10 to 12 of chapter 2 of the Underwriting Requirements.
- Franchisees of lead syndicates should ensure that contracts have been agreed, signed and dated by the coverholders to whom authority is delegated, and by the lead underwriter, prior to inception of the contract.
- Franchisees should ensure that where there is a series of wholesale or retail producers in the chain who will bind insurances and/or issue documents, they have a direct contract with each party in the chain in accordance with the Delegated Underwriting Byelaw.
- **To satisfy Contract Certainty requirements with regard to the timely delivery of insurance documents, Managing Agents should require each coverholder to confirm that insurance documents have been issued within required timescales. The form and frequency of this return from coverholders should reflect the Managing Agent's assessment of risk, while ensuring that returns are received at least annually from each coverholder. The development of Oracle provides a platform which could address this requirement.**

UNDERWRITING MANAGEMENT

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3 DELEGATED UNDERWRITING

Proactive Management

- Franchisees should monitor the performance of the coverholder to whom they have delegated authority. To monitor performance, franchisees should specify which information the entity is required to provide, and its frequency, within the binding authority. Performance monitoring for binding authorities will usually include consideration of:
  - the type, class, volume and quality of business accepted under the binding authority and a comparison of performance against the initial plan;
  - changes in market conditions and the binding authority's profitability;
  - how the coverholder administers and operates the binding authority (including keeping to service standards);
  - significant changes to the coverholders or Lloyd's broker's circumstances; and
  - other problems or potential issues (for example those that may have been revealed by any audit or underwriting visits, complaints or potential litigation or regulatory issues.)
- Franchisees should develop and implement a policy which governs their approach to the use of independent (internal or external) audit of entities to which they delegate authority. This policy will normally address:
  - the frequency of audits based on the managing agent's risk assessment of the entity.
  - the scope for review to be included in the terms of reference for the auditors.
  - the identification of appropriately skilled auditors able to fulfil the terms of reference.
  - the identification of key audit recommendations and their implementation.
- Franchisees should have specific procedures in place to ensure ongoing adherence by the entity to relevant Lloyd's requirements and local regulations.

- Franchisees need to have clearly defined procedures, (including notification to Lloyd's), to be implemented in the event that irregularities (such as fraud and dishonesty) are identified at a coverholder.
- Franchisees are expected to deal with non-renewal or cancellation of a delegated underwriting contract in an appropriate manner.
- Franchisees are expected to have a process to monitor their own management of delegated underwriting arrangements.

The following Additional Notes are intended to assist franchisees with the implementation of the Underwriting Standards

UNDERWRITING MANAGEMENT

ADDITIONAL NOTES

3 DELEGATED AUTHORITY

Delegated Underwriting Byelaw:- *the standards under this section are in line with the requirements of the Byelaw.*

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