LLOYD'S

Lloyd's Minimum Standards MS3 – Price and Rate Monitoring

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MS3 – Price and Rate Monitoring

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

Benchmark Premium: The price for each risk at which the managing agent is expected to deliver their required results, in line with the approved Syndicate Business Plan.

Catastrophe Modelling: (also known as cat modelling) is the process of using computer-assisted calculations to estimate the losses that could be sustained due to a catastrophic event such as a hurricane or earthquake.

Delegated Authority: all forms of business where underwriting and claims authority has been delegated to another entity (e.g. binding authorities, consortia, lineslips etc.).

ERM: Enterprise Risk Management

ILW: Industry Loss Warranty

KPIs: Key Performance Indicators

LCM: Lloyd's Catastrophe Model

LCR: Lloyd's Capital Return

LITA: Lloyd's Internal Trading Advice

Lloyd's Returns: this will include, but not be limited to: Broker Remuneration Return; LCM Submissions; PMDR; QMB; RDL; RDS; Related Parties Return; SBF; Self-Assessment of Compliance versus Lloyd's Underwriting and Claims Standards; Syndicate Business Plan; Syndicate Reinsurance Programme Return; Xchanging Claims

ORSA: Own Risk and Solvency Assessment

PBQA: Pre-Bind Quality Assurance

PMDR: Performance Management Data Return

QMA: Quarterly Monitoring Return – Part A

QMB: Quarterly Monitoring Return – Part B

RARC: Risk Adjusted Rate Change

RDL: Realistic Disaster Scenario (Light)

RDS: Realistic Disaster Scenario

Related Party: A related party shall mean:

- Any company within the same group as the managing agent
- Another syndicate managed by the same managing agent or a service company coverholder that is part of the managing agent's group.
- Any company which has two or more directors in common with the managing agent
- Any company within the same group as a corporate member of the syndicate which has a member's syndicate premium limit of more than 10% of the syndicate allocated capacity

Risk Appetite: Is the level of risk that an organisation is prepared to accept, before action is deemed necessary to reduce it.

ROC: return on capital

SBF: Syndicate Business Forecast

SRP: Syndicate Reinsurance Programme

Syndicate Business Plan: means a business plan prepared by a managing agent in accordance with paragraph 14A of the Underwriting Byelaw.

The Board: Where reference is made to the Board in the standards, managing 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 the materials items.

Ultimate Net Loss: The Reinsurer's gross loss less any recoveries from other reinsurance which reduces the loss to the reinsurance contract.

Underwriting Data: this will include, but not be limited to all data which the managing agent, Lloyd's or other appropriate regulators require to monitor the business with regard to underwriting activities.

MS3 – Price and rate monitoring

UW 3.1 Price and Rate Monitoring Framework

Managing agents shall have an effective pricing and rate monitoring framework in place for each managed syndicate.

Managing agents shall ensure that:

- there is a nominated director responsible for pricing and rate monitoring procedures;
- for each managed syndicate there is a direct link between the written Risk Appetite, the Syndicate Business Plan and pricing parameters and
- for each managed syndicate there is a written Pricing Policy which provides a clear expectation of pricing levels and explanation on how pricing will deliver the projected results within the Syndicate Business Plan and how pricing will be managed over the relevant underwriting cycle.

Clear Ownership

Lloyd's expects the managing agent's Board to nominate one director to be responsible for the managing agent's pricing and rate monitoring procedures. The nominated director and supporting staff will need to have the requisite skills, experience and available time to manage and execute the process effectively. The managing agent's Board shall be provided with a report comparing the outcome of the pricing and rate monitoring processes against the Syndicate Business Plan targets, at least quarterly across all sources of business, including open market and delegated authority business.

Risk Appetite and Pricing Parameters

It is expected that for each managed syndicate Risk Appetite is articulated at portfolio level and cascaded to each class of business. This articulation and cascade of Risk Appetite should flow through into the detail of coverage to be provided and coverage which is to be excluded.

The Risk Appetite, including profit and Return on Capital (ROC) requirements should be reflected in the Syndicate Business Plan and the pricing parameters should be set to deliver the Syndicate Business Plan in line with the syndicate's Risk Appetite.

Pricing Policy

Managing agents shall ensure that there is a demonstrable and transparent written Pricing Policy which provides a clear expectation of pricing levels and explanation on how pricing will deliver the projected results within the Syndicate Business Plan In addition, Lloyd's will need to understand how managing agents intend to manage their pricing if their approach to the underwriting cycle conflicts with the Syndicate Business Plan/strategy. The Pricing Policy should reference the following topics:

- Syndicate Risk Appetite and Strategy and how this links to pricing;
- Responsibility for the Pricing Policy;
- How pricing is to be calculated for each class of business;
- Expectation of pricing levels and escalation requirements;

- Benchmark Premium – how calculated and used by underwriters;
- Risk Adjusted Rate Change (RARC);
- Monitoring of pricing including PMDR information supplied to Lloyd's;
- Controls to mitigate the risk of anti-selection
- Audit and review of pricing;
- Information provided to the managing agency Board and syndicate committees regarding pricing and rate change; and
- Agreed definitions within the Pricing Policy.

Required Evidence

- Information provided to the managing agency Board and committees;
- Pricing Policy and procedures;
- PMDR information;
- Any other MI.

UW 3.2 Pricing Methodology

Managing agents shall have appropriate pricing methodologies for each managed syndicate.

Managing agents shall ensure that:

- there are written pricing procedures and methodologies which are transparent and consistent for each class of business;
- Benchmark Premiums are supported by relevant experience / exposure data within a structured process / model;
- the pricing process demonstrates the expected loss ratio for each risk and the key rating factors being used with their relative value where appropriate;
- models are reviewed at least annually and re-calibrated as appropriate by personnel with relevant experience, (such as actuaries) in line with planned loss ratios;
- the pricing for attritional / large losses and cat losses is explicit;
- the rationale for underwriting and pricing of each risk is recorded by the underwriter; there are written guidelines in place to assist the underwriter in using the process / model; and
- guidelines include escalation process of any deviations.

Appropriate Pricing Procedures and Methodologies

It is expected that managing agents will have appropriate systems and controls for the effective management of pricing for each syndicate, including full version control over changes to the model, and that such systems and controls will be set out in writing.

In order to ensure that the syndicates they manage generate sufficient premiums in the aggregate to achieve the planned levels of profitability in the Syndicate Business Plan, managing agents pricing methodologies should be transparent and consistent for each class of business.

Such a pricing process should capture all the relevant elements of the pricing calculation, the methodology used and the evaluation carried out. It should be able to demonstrate:

- The expected loss ratio over time for each risk (calculated at individual risk, portfolio or other appropriate level); and
- The key rating factors being used, with the relative value applied to each of these as appropriate.

An appropriate pricing methodology will be dependent upon a number of factors including the size of the managing agent, the experience of the underwriters, the availability of relevant loss and exposure data, the complexity of the class of business and the speed at which pricing calculations need to be carried out.

In considering pricing methodology, all elements of the pricing calculation are expected to be included, for example:

- there are written guidelines in place to assist the underwriter in using the process / model.expected loss cost;
- CAT load, internal expenses;
- profit and acquisition costs;
- the actual price charged; and
- the resultant level of profit anticipated.

The “expected loss ratio for each risk” would normally be projected at an individual risk level, although it is recognised that this is not always possible. Where loss ratios are projected at portfolio or another level, managing agents should be able to explain the rationale.

Benchmark Premiums

Benchmark Premium is based on the Gross Ultimate Loss Ratio in the Syndicate Business Plan. A statement that there is 100% Benchmark price indicates that the premium achieved is expected to deliver the Syndicate Business Plan loss ratio.

Benchmark Premium should be easy to calibrate to a syndicate’s own definition and is an absolute measure of the expected gross net underwriting profitability of a risk. There should be alignment between the managing agent’s pricing methodologies and the calculation of Benchmark Premiums.

Benchmark price information is required by Lloyd’s for both new and renewed business.

For further information on Benchmark Premiums / price please refer to the PMDR section on lloyds.com which can be found at the following link:

[Link to Lloyd’s PMDR can be found in the Appendix at the end of this document]

Review of Models

Managing agents should ensure that there is an annual documented decision on whether review of individual pricing models is required. Where a review is required, any re-calibration should be undertaken by personnel with relevant experience, such as actuaries.

Monitoring of actual results against the Syndicate Business Plan and Risk Appetite should also be used to review and/or recalibrate pricing parameters within models at least annually to ensure delivery of the Syndicate Business Plan can be maintained across the underwriting cycle.

Pricing for Attritional and Large / Cat Losses

The pricing for attritional and large losses should be determined separately and explicitly from the pricing for cat losses and the pricing of individual cat perils where included.

Rationale for Pricing

There needs to be a rationale for the underwriting and pricing of each risk, even if the rationale applies across a portfolio or homogenous group of risks.

Written Guidelines

Managing agents should consider using written guidelines to assist the underwriter in using the pricing process / model and recording rate changes. These should include:

- A description on how the model output should be interpreted for each class of business (i.e. the actions to be taken when the price is above, similar to or below the price offered);
- The requirements for escalation (e.g. when a risk needs to be referred to an appropriate individual for a second opinion or sign-off);
- Any requirements for line size utilisation / grading dependent on price adequacy; and
- How to assess RARC or record appropriate information to ensure that this can be provided to Lloyd's as part of PMDR;
- written guidelines with description of which model and which aspect should be used (for example exposure v, frequency)

To support the written guidelines, Lloyd's advocates that managing agents hold regular underwriter meetings to discuss the pricing of a selection of risks, with key agreed actions being recorded as part of the underwriter's rationale for the pricing of the risk.

Required Evidence

- Pricing tools and models; and
- Written Guidelines.

UW 3.3 Price Adequacy and Rate Change Management and Monitoring

Managing agents shall have effective price adequacy and rate change management and monitoring in place for each managed syndicate

Managing agents shall ensure that:

- there is a nominated director with responsibility for assessing and calculating the impact that pricing movements, new business and non-renewed business may have on the syndicate loss ratios;
- pricing and rate change monitoring is undertaken for all sources of business, including open market and delegated authority business, at regular intervals throughout the life of the contract;
- for each managed syndicate there is measurement of the difference between the actual premium charged against the Benchmark Premium established by the managing agent;
- for each managed syndicate there is measurement for renewal business of pricing movements from the previous year in accordance with Lloyd's requirements (RARC);
- there are written guidelines in place with regard to the quantification of pricing movements and technical price benchmarking to ensure consistency of approach between underwriters.

Effective Rate Monitoring Processes

The use of an effective price adequacy and rate monitoring process represents sound business practice, enabling managing agents to manage syndicates in a well informed and prudent manner. In particular, it enables the managing agent to:

- Assess rate adequacy;
- Monitor pricing movements;
- Assess the impact that such pricing movements may have on the syndicate's loss ratios;
- Review and amend the syndicate underwriting strategies and the Syndicate Business Plan;
- Make informed decisions on reserving strategy;
- An effective rate monitoring process which will contain the following:

    - It records the various elements of the pricing calculation for each risk (calculated at individual risk, portfolio or other appropriate level);
    - It monitors the difference between the Benchmark price and the actual price at suitable levels (eg per risk, risk code, class of business) and allows the business to act on variances in pricing margins and exposure accepted compared to approved plan;
    - In respect of renewals, it monitors pricing movements against the previous period(s) of insurance;
    - It provides written guidance for underwriters, setting out how they are to record and quantify pricing movements so as to ensure consistency of approach between underwriters;
    - It incorporates a regular review process to ensure that the input data is accurate, consistent and reliable; and
    - It allows the actuarial and business planning functions to analyse separately the various elements of any premium, policy cover and exposures as well as external factors such as inflation.
    - It provides for analysis of pricing movements across all sources of business, including open market and delegated authority. In particular, in respect of delegated authority business, it ensures that a review of benchmark price and risk adjusted rate change is undertaken at regular intervals, at least quarterly, during the life of a binding authority contract.

Managing agents should be regularly testing the assumptions made in their SBF to ensure that they are on track to meet plan and can make appropriate corrections or amendments as necessary. The premium bridging analysis which forms part of the SBF submission (form 183) provides a useful summary of how the plan was developed.

Impact of Pricing Movements

It is important that managing agents have processes in place to ensure that there is assessment of the impact of pricing movements, new business and non-renewed business on syndicate loss ratios and the current portfolio.

Managing agents should determine an appropriate approach in regard to analysis of non renewed business which may focus on larger accounts, the aggregate impact of non-renewing a number of smaller accounts, accounts with prior year achieved premiums significantly above or below Benchmark Premium.

RARC (Risk Adjusted Rate Change)

To calculate RARC:

$$\frac{\text{Price charged this year} - \text{Price charged for this year's coverage last year}}{\text{Price charged for this year's coverage last year}}$$

[Link to Lloyd's PMDR guidance can be found in the Appendix at the end of this document]

Potential Evidence

- PMDR information;
- Written Guidelines; and

UW 3.4 Price and Rate Monitoring Audit and Review

Managing Agents shall have effective systems and controls in place to audit and review pricing and rate monitoring for each managed syndicate

Managing agents shall ensure that:

- all relevant pricing and rate monitoring information is recorded by underwriters with regular internal reviews and checks;
- personnel with relevant experience (such as actuaries) periodically check that pricing models are being used appropriately;
- terms of reference for Independent Reviewers include a requirement to review pricing and rate monitoring to ensure consistency of approach with stated policies of the syndicate; and
- the Board is provided with a report, at least quarterly, which compares the outcome of the pricing and rate monitoring processes against the Syndicate Business Plan targets.

Reviewing Pricing Activity

It is expected that a process of review will be in place to ensure that the managing agent's pricing methodologies are being adhered to.

Independent Review

The role of the Independent Reviewer is to provide the managing agency Board and management with regular reports, in line with their Terms of Reference to provide independent assurance as to the extent to which the syndicate's strategies and pricing/ underwriting policies are being applied correctly and consistently based on the review of a selection of risks written recently by the underwriters.

Please refer to feedback and guidance on a) Peer and Independent review and b) Terms of Reference for Independent Review which can be found at the following link:

[Link to Peer and Independent Review can be found in the Appendix at the end of this document]

[Link to Guidance on Terms of Reference for Independent Review can be found in the Appendix at the end of this document]

Board Reports

Managing agents are expected to share the monthly Lloyd's PMDR feedback and quarterly Lloyd's Performance Information Pack with the Board as part of their reporting on price and rate monitoring across all sources of business, including open market and delegated authority, and against the Syndicate Business Plan targets.

Potential Evidence

- Terms of reference for Independent Reviewer(s);
- Independent Reviewer(s) reports; and
- Information provided to the managing agency Board and committees.

Appendix – Links

- Lloyd's PMDR:

http://www.lloyds.com/pmdr

- Peer and Independent Review:

https://www.lloyds.com/market-resources/underwriting/independent-reviewers

- Guidance on Terms of Reference for Independent Review:

https://www.lloyds.com/market-resources/underwriting/independent-reviewers