LLOYD'S

Lloyd's Minimum Standards MS2 – Underwriting and Controls

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MS2: Underwriting and Controls

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 that they meet the Minimum Standards.

Definitions

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

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

PBQA: pre-bind quality assurance

PMDR: performance management data return

QMA: Quarterly Monitoring Return – Part A

QMB: Quarterly Monitoring Return – Part B

RDL: Realistic Disaster Scenario (Light)

RDS: Realistic Disaster Scenario

Related Party: A related party shall mean:

1. Any company within the same group as the managing agent.
2. Another syndicate managed by the same managing agent or a service company coverholder that is part of the managing agent's group.
3. Any company which has two or more directors in common with the managing agent
4. 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

SBF: Syndicate Business Forecast

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 material items.

MS2: Underwriting and Controls

UW 2.1 Underwriting & Controls Framework

Managing agents shall have an effective underwriting systems and controls framework in place for each managed syndicate

Managing agents shall ensure that:

- there is a nominated director responsible for underwriting systems and controls;
- for each managed syndicate there is a written Underwriting Policy and/or Underwriting Procedures;
- underwriting is aligned to the strategy, approved Syndicate Business Plan and Underwriting Policy/Procedures and takes account of pricing levels, updated aggregate exposures and reinsurance arrangements;
- underwriters' terms of reference / authorities are in writing, properly authorised and signed, and reviewed annually to reflect his / her experience and knowledge and are aligned to the Syndicate Business Plan;
- risks that are outside of an underwriter's agreed level of authority are referred to an appropriate individual;
- there are requirements to achieve Pre-Bind Quality Assurance (PBQA) using a risk based approach, whether in a lead or follow position;
- there are appropriate procedures and resources for review and agreement of contract wordings, including requirements to achieve Contract Certainty; and
- underwriting addresses external regulatory requirements.

Effective systems and control

Effective systems and controls are essential for the delivery of the managing agent's strategy and Syndicate Business Plan. To facilitate this, it is expected that the managing agent's Board will nominate one director such as the Chief Underwriting Officer, Active Underwriter or Head of Underwriting Management or similar, to be responsible for the managing agent's underwriting systems and controls. The managing agent shall ensure that the nominated director and supporting staff have the requisite skills, experience and time available 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 underwriter’s authority and of any variances to prescribed procedures/authorities; and
- Detection controls - These include, for example, internal audit reviews, peer review processes and independent reviews.

Managing agents' controls would normally be risk based.

Underwriting Policy and Underwriting Procedures

Managing agents shall maintain have documented systems and controls for the effective management of each syndicate aligned with strategy and business planning. These will normally consist of an Underwriting Policy and underlying Underwriting Procedures.

The Underwriting Policy would usually include an overarching underwriting strategy and generic controls that apply across all lines of business, whilst the Underwriting Procedures would usually include more specific guidelines, processes and controls to implement the policy at class of business level these documents will typically cover the following elements for each syndicate:

- Reporting lines and Committee framework
- Underwriting authorities and line guide details by class of business;
- a process for authorising material deviations from the business plan or line guide requirements;
- systems and controls in place for managing any conflicts of interest relating to any current or proposed underwriting transaction
- Peer and independent review procedures
- Delegated authority procedures
- Compliance with regulations including sanctions, financial crime, conduct, etc
- approach to fronting business for other insurers;
- approach to multi-year policies;
- approach to ensuring that Contract Certainty and Pre-Bind Quality Assurance is achieved;
- 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;
- aggregates are managed within the parameters of the approved business plan; and
- appropriate reinsurance coverage is in place.

Managing agents are also expected to ensure that underwriting takes in to account Lloyd's Supplementary Requirements and Guidance.

[Link to Supplementary Requirements and Guidance]

Multi-Platform Underwriting Protocols

Where a managing agent manages more than one syndicate and/or is part of a group consisting both of a syndicate under the management of the managing agent and group (re)insurance company(ies), then the managing agent should have a documented policy for the allocation of business between syndicates managed by it and/or between the syndicate(s) managed by it and any group (re)insurance companies. The policy should set out objective and clear criteria for the allocation of business and be reflected in Underwriting Authorities. managing agents should, where possible, avoid having criteria that allow for a material level of discretion in the allocation of business. Lloyd's would expect that the criteria would be outlined by class of business and take into account a variety of factors including licencing, line size and client choice. The policy should also address conflict of interest at the [entity/firm] level and at the level of individual underwriters who may have authority to underwrite for more than one syndicate and/or a syndicate and one or more group companies. (Note that where an individual underwriter is authorised to underwriters for two or more syndicates then approval from Lloyd's will be required pursuant to the Multiple Syndicate Byelaw.)

The Underwriters' 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 Syndicate Business Plan. Each underwriter should signify agreement by signing his / her authority details and it should be counter-signed by the Active Underwriter or as delegated to a senior underwriter, such as a Class Underwriter The Active Underwriter's authority should be counter-signed by a member of the Board. Electronic signatures and counter-signatures are acceptable.

The letter of authority should specify the legal entity for which the Underwriter has authority and the effective period i.e. for each Underwriting Year. Risks that are outside of the underwriter's agreed level of authority must be escalated to another individual with the appropriate level of authority and this process should be clearly defined and understood, with such escalations properly recorded.

Lloyd's would expect that the Underwriting Authorities will reference the following elements:

- authorised lines of business, including relevant Lloyd's risk codes
- maximum line size
- maximum GPW per risk or programme
- territorial limits, including specific territories that should not be written
- method of placement (i.e. including Binders, Treaty Reinsurance etc
- authority for endorsement agreement
- authority to purchase reinsurance,
- reinsurance exclusions or limitations
- maximum policy periods
- maximum brokerage/commissions allowed
- variation to Benchmark price
- referral procedure for risks outside of an underwriter's authority
- protocol for writing across Lloyd's and non-Lloyd's platforms
- All currencies to be clearly stated and maximum line sizes to be aligned with the latest approved SBF max line sizes in denominated currencies (GBP, USD, EUR, AUD, CAD) and where applicable all currency conversion to GBP or other denominated currencies must be converted at the current SBF rates of exchange.

Pre-Bind Quality Assurance (PBQA), Contract Quality and Contract Certainty

Managing agents should maintain effective, risk based PBQA procedures whether as lead or follow market, with clear accountability for their operation and a review process to ensure that they remain appropriate to the managing agent's specific business requirements.

Features of an effective process are likely to include clearly defined criteria for PBQA checks to apply, taking into account:

- Class of business;
- Size of line;
- Brokers' wordings performance;
- Type of wording – bespoke or complex, use of standard terms;
- Individual underwriter's knowledge and experience of the territories/ class of business / wordings;
- Availability of specialist wordings/ legal knowledge of insurance contract law;
- Assessment of the leader's capability, where following; and
- Ensuring that reinsurance slips have appropriate reinsurance conditions and clarity regarding underlying/associated wordings.

There should be continuing assessment of the quality of slips and wordings. Managing agents should be utilising specialist wordings / legal personnel with appropriate skill, knowledge and experience; as necessary; and also consider using commercial software products to assist with the review and comparison of slips and wordings.

There should be regular reporting to the relevant committees within the managing agent and feedback to underwriters on contract quality and contract certainty of slips and wordings which take into account items such as:

- 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 on a risk based approach;
- An assessment/ vetting of the performance of leaders for each class of business against the in house PBQA procedures;
- Any issues regarding reinsurance slip conditions or underlying/associated wording; and
- Feedback from Lloyd's review process.

Available tools/ information

When considering their required procedures, Lloyd's strongly suggests to managing agents that they consider the following sources of assistance regarding placement activity, accessible anywhere in the world via lloyds.com or via the London Market Group website where noted.

- Contract Certainty principles and guidance notes, all via the London Market Group website:

[Link to London Market Group Website]

- The Market Reform Contract (MRC) template and guidance documents addressing open market, lineslips and delegated authority business. There is no requirement to use either the generic template or extensive guidance on slip content, although it should be noted that these were developed by market practitioners, largely to satisfy the need for contract certainty.
- The Lloyd's Wordings Repository (of model clauses & wordings) – a readily available source of model wordings and a home for managing agents who want to retain their own wordings safely and securely, with international access via lloyds.com. This can be found at the following link:

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

- Lloyd's QA Tools – a source of checks against which slips can be reviewed which can be found at the following link:

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

- Crystal for extensive Lloyd's tax and regulatory information held at country level available which can be found at the following link:

[Link to Crystal can be found in the Appendix at the end of this document]

Contract certainty in the placement of business in overseas territories

These notes are not intended to replace or revise the requirements that Lloyd's already places upon managing agents involved in local underwriting carried out by coverholders, or service companies.

Lloyd's recognises that London placement practices are not always easily transferable to overseas territories. Where existing Lloyd's tools/guidance can be used to good effect Lloyd's recommends that as good practice. Where managing agents operate alternative approaches which can be demonstrated to be effective Lloyd's has no concerns.

Managing agents operating in overseas markets are encouraged to adopt Lloyd's subscription business processes where risks are co-insured, to assist in the delivery of contract certainty, and for greater process efficiency for all partiesIt is expected that all managing agents will be monitoring the standard of contracts being entered into where risks are being accepted in overseas territories by syndicates, or entities to whom they have delegated their authority.

It can be expected that Lloyd's will, in the first instance, make requests to the managing agent's risk and compliance team for evidence of the extent to which slips meet contract certainty and the managing agent's own risk-based procedures. Thereafter, specific enquiries may be made within overseas territories, working with the managing agent's leadership team.

External Regulatory Requirements

Managing agents 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.

Lloyd's supplies both tax and regulatory information, by territory, within Crystal. Managing agents should monitor requirements in the territories where they operate and are encouraged to use the Risk Locator and QA Tools to check that the slip and/or contract wording is compliant. Managing agents should discuss any issues or concerns with Lloyd's Internal Trading Advice (LITA) and/or Lloyd's local managers.

[Links to Crystal, Risk Locator and the QA Tools can be found in the Appendix at the end of this document]

Potential Evidence

- Relevant role profiles/job descriptions e.g. CUO, Active Underwriter etc.
- Terms of Reference for Underwriting Committees (or other relevant committees)
- Packs/minutes of Underwriting Committee (or other similar committees)
- Underwriting Policy;
- Underwriting Procedures;
- Underwriting Guidelines for specific classes of business;
- Underwriting Authority statements;
- PBQA procedures; and
- Contract wording review procedures, including Contract Certainty.

UW 2.2 Underwriting & Controls Audit and Review

Managing agents shall have effective systems and controls in place to audit and review underwriting for each managed syndicate

Managing agents shall ensure that:

- they keep (or have the right to access) all relevant information in respect of each risk underwritten including the slip and the placing documentation;
- there is regular exception reporting to identify potential variances or control failures and these are investigated and reported/escalated;
- underwriting decisions are subject to a Peer Review process
- a representative range of risks underwritten by the syndicate is reviewed and assessed regularly by an appropriately qualified Independent Reviewer; and
- underwriting controls are subject to regular and appropriate internal audit review.

Retention of all relevant information

Each managing agent 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.

Regarding Delegated Authority where aggregated returns are received by the managing agent, Lloyd's expects that data at individual risk level to be available to the managing agent to ensure that underwriting controls are working effectively.

Relevant information would include slips and placing information, as well as the rationale for risk acceptance, terms and pricing.

Testing of underwriting controls

Managing agents are expected to test and record the effectiveness of underwriting controls on at least a quarterly basis, 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 and monitored. Key findings should be reported to the Board as appropriate . Testing should ideally include consideration of referrals and breaches of underwriting authority, 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.

Peer Review

The scope of managing agents' peer review activities should reflect the scale and complexity of their portfolios. Consideration will normally be given to review of all significant underwriting decisions. This could extend to quotations, acceptance of new business, endorsements and renewal terms.

Please refer to feedback and additional guidance on Peer and Independent review which can be found in the Appendix at the end of this document.

Independent Review

The role of the Independent Reviewer is to provide the Managing Agency Board and management with regular (at least quarterly) reports 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 in the Appendix at the end of this document.

Potential Evidence

- List of exception reports including detail on frequency;
- Exception reports from the underwriting system;
- Terms of reference for Independent Reviewer(s) and names of reviewers for each class of business;
- Independent Reviewer(s) reports;
- Peer review process and comments for individual risks;
- Internal Audit plan and reports; and
- Information provided to the managing agency Board and committees.

Appendix – Links

- Crystal:

http://www.lloyds.com/the-market/tools-and-resources/tools-e-services/crystal

- London Market Group Website:

http://www.londonmarketgroup.co.uk/

- Lloyd's Wordings Repository:

http://www.lloyds.com/the-market/tools-and-resources/tools-e-services/lloyds-wordings-repository

- Lloyd's QA tools:

http://www.lloyds.com/qatool

- Risk Locator:

https://www.lloyds.com/the-market/tools-and-resources/tools-e-services/risk-locator

- Guidance on Peer Review:
- Guidance on Terms of Reference for Independent Review:

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