LLOYD'S

Lloyd's Minimum Standards

MS8 - Reserving

January 2021

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Minimum Standards and Requirements

The Minimum Standards are statements of the business conduct required by Lloyd's, established under relevant Lloyd's Byelaws. The Requirements represent the minimum level of performance required of any organisation within the Lloyd's market. All managing agents are expected to comply with the Minimum Standards.

Within this document the standards and supporting requirements 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. It is 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 how these meet the Minimum Standards.

Definitions

AFR – Actuarial Function Report

GQD – Gross Quarterly Data

IFoA – Institute and Faculty of Actuaries

MI – Management Information

ORSA – Own Risk and Solvency Assessment

PRA – Prudential Regulation Authority

SAF – Syndicate Actuarial Function

SAO – Statement of Actuarial Opinion

TAS – Technical Actuarial Standards

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.

TPD – Technical Provisions Data

TPs – Technical Provisions

Section 1: Board Responsibility

RS 1.1 Board Responsibility

The Board of the managing agent shall be responsible for setting reserves.

The Board of the managing agent shall:

- be responsible for setting reserves for both Financial Accounting and Solvency;
- understand the key assumptions, methodologies and uncertainties associated with the reserves;
- provide objective challenge to the process used to set the reserves and the recommendations made by the reserving function;
- direct appropriate action given movements in historical reserves, in particular seeking assurance on reserve adequacy following any deteriorations; and
- ensure there is consistency of assumptions between reserving, pricing, capital modelling, business planning and financial reporting.

Setting reserves

Reserve setting is the responsibility of the managing agent's Board. If Lloyd's believes there is an unduly high risk that the reserves will prove to be inadequate, Lloyd's will engage closely with the agent and expect the Board to fully support this engagement.

Boards should ensure that all requirements relating to reserve setting are met. The Board's responsibility for setting reserves extends to those reserves set for unexpired risks, which under Solvency II may be more or less than the unearned premiums.

Any committee providing recommendations to the Board does not replace the requirements of the Board. In many managing agents, there is a reserving committee that brings together the appropriate experts and makes a recommendation for the Board to consider. Lloyd's supports the use of such a structure when the managing agent believes it works best, but the existence of an expert reserving committee does not remove the requirement for the Board to give due consideration to the reserve decisions and to be ultimately responsible for the result.

Key assumptions, methodologies and uncertainties

The Board should understand the key assumptions, methodologies and uncertainties underlying the reserves. This includes the key reserving judgements made in light of the current point in the market cycle, socio-economic factors affecting the insurance market as well as external changes or shocks for expected changes, or uncertainties, in legislation. The Board should be aware of and consider communications from Lloyd's when setting the reserves. The Board should also consider the appropriateness of the reserves by class of business given the importance of reserving to planning, capital and pricing.

Where the Board does not retain the relevant knowledge, they should seek training either internally within the managing agent or externally.

Objective challenge

The Board should allocate sufficient time to consider reserves and must provide an objective challenge to the proposals brought to them. The Board is responsible to ensure the information provided is sufficient to support this level of challenge. Lloyd's may require copies of Board or reserve committee packs and minutes to review the discussions that were held, and will look to the Board as the ultimate authority for questions on reserves. As well as the above information, Lloyd’s may request access to independent non-executive directors (NEDs) and the Signing Actuaries providing the Statement of Actuarial Opinion.

The Board should challenge the process that had been used to set the reserves. As part of their challenge the Board should consider the historical experience of the Syndicate against expectation and the validity of use of assumptions from other processes, such as business planning, in reserve setting. In addition, credit taken for initiatives/changes which do not yet have a track record is expected to be closely scrutinized by the Board.

Appropriate action

In response to material movements in reserves the Board is expected to direct appropriate action to understand the underlying drivers of these movements and gain assurance on the adequacy of the latest reserves. This should include, but not be limited to, consideration of the validity of any credit taken for any process changes or remedial action/improvements in underwriting or claims.

In the event of material or persistent reserve deteriorations Lloyd’s expects a comprehensive plan of these actions to be available on request.

Consistency

Information and assumptions used in the reserving process should be linked and, where appropriate, consistent with those used in capital modelling, pricing, business planning and financial reporting. Any use of inconsistent assumptions should be clearly justified.

Section 2: Board Information

RS 2.1 Board Information

Managing agents shall ensure that sufficient information is supplied to the Board to fully inform their responsibility for reserve setting and providing objective challenge.

Managing agents shall ensure that information provided to the Board:

- is accurate;
- is accompanied by analysis which includes discussion of emerging experience, key assumptions, uncertainties and market conditions; and
- includes relevant external information

For the Board to reach conclusions on reserves and provide the necessary objective challenge, they should be provided with accurate, appropriate and sufficient information.

Lloyd's expects the managing agent to provide, on request, copies of any information relating to reserving.

Accuracy

The managing agent should have appropriate processes and procedures in place to ensure the accuracy of reserve information provided to the Board.

Analysis

The information provided should be accompanied by analysis covering material aspects of the reserves. The items listed in this section do not represent a checklist for fulfilling this requirement; the managing agent must be satisfied that the information is complete and appropriate, including that attention is appropriately drawn to more material or higher risk areas.

The information should cover both internal and external factors including any emerging risks, emerging experience and adjustments made considering this; changes in exposures, placement types and terms and conditions; and information on market conditions. The information on market conditions is relevant due to the reserving cycle - reserves set at times of weaker rating environments have historically been more prone to deterioration than those set at points with higher premium rating. The Board should be aware of this reserving cycle effect and consider whether any adjustment to account for this is appropriate.

Relatively high-risk areas should be covered in more detail. Examples of high risk areas include, but are not limited to: large accounts, lines of business with greater inherent uncertainty, new lines, accounts with higher claims than expected, lines where there has been a change to the underwriting, lines where there has been a material release due to changes in methodology and assumptions, lines where there has been deterioration since the previous reserve analysis and lines with special reinsurance characteristics such as a risk of exhaustion.

The Board should ensure an appropriate level of internal and external actuarial analysis is provided to support their reserve setting responsibility. If an external actuary has recommended reserves or has provided an independent estimate of the reserves, the Board should consider their analysis, including material differences at a class of business level, and have the opportunity to challenge this. A good practice is for non-executive directors to meet the external actuary without the executive Board members in attendance.

Board Feedback

The managing agent should provide a channel whereby feedback can be provided from the Board to the reserving team should there be a need for any clarification, additional analysis or changes to the reserve estimates. There also needs to be a mechanism in place whereby the information or reserve estimates can be re-reviewed by the Board following feedback.

External information

The Board should be aware of any guidance and feedback information relevant to reserving provided to the syndicate by Lloyd's or other recognized body such as the Prudential Regulation Authority ("PRA"). Lloyd's will periodically meet with managing agents to discuss reserving. Lloyd's expects that where appropriate and/or required by Lloyd's, managing agents will escalate issues or actions arising from these meetings to the Board.

Section 3: Actuarial Function

RS 3.1 Actuarial Function

Managing agents shall ensure that an Actuarial Function is in place.

In respect of coordination of the calculation of technical provisions ("TPs"), the Actuarial Function carries out the duties required to meet all Solvency II tests and standards. Managing agents shall:

- ensure the accuracy, completeness and appropriateness of data;
- ensure the use of appropriate methods and assumptions;
- undertake an analysis of actual versus expected experience as well as other required validations;
- produce ultimate loss ratio development charts as management information in respect of reserve robustness;
- produce a report ('The Actuarial Function Report') to the Board, at least annually, documenting all tasks undertaken, identifying deficiencies and making recommendations to remedy these deficiencies;
- ensure the report includes a reasoned analysis on the reliability and adequacy of the calculation of the TPs and on the sources and degree of uncertainty in the TPs; and
- ensure the validation process for the technical provisions is appropriately designed, proportionate to the risks and is sufficiently detailed and robust.

Under Solvency II there is a requirement for all firms to have an Actuarial Function in place. This requirement applies both to Lloyd's centrally and managing agents.

Managing agents will have Syndicate Actuarial Functions (SAFs) led by the Chief Actuary. The Chief Actuary should be appointed under the PRA's Senior Managers & Certification Regime in Senior Management Function 20 (SMF20). Lloyd's expects to be notified of any prospective change of Chief Actuary. Lloyd's maintains a record of Chief Actuaries and will use these details to communicate key messages relevant to reserving. It is the responsibility of the Chief Actuary to ensure these messages are appropriately disseminated to their team.

The SAF governance structure is not prescribed by Lloyd's. Managing agents should ensure that the structure in place allows the function to comply with all Solvency II specifications and PRA guidance, such as being independent of revenue-generating functions and providing robust challenge. These requirements do have regard to the nature, scale and complexity of the business.

Lloyd's requirements for SAF reporting, and associated guidance is provided on www.lloyds.com

Section 4: Reserving Procedure

RS 4.1 Reserving Procedure

Managing agents shall ensure they have a robust reserving procedure.

The managing agent shall ensure that:

- those conducting the reserving analysis have appropriate skills and knowledge;
- the procedure incorporates justification and validation of the methods and assumptions used;
- feedback loops are included in the procedure;
- the procedure is in line with guidance from Lloyd's, the PRA and any other relevant professional bodies;
- the actuarial function is managed in line with the PRA's Senior Managers Regime; and
- internal audit periodically review reserving processes including validation of methods and results.

From time to time Lloyd's may request data, information, or documentation collectively referred to as information as part of its regular monitoring activities. This request may include Lloyd's taking the information off site or for access to key personnel and working files on site. Lloyd's expects this information to be made available in a timely manner, dependent on materiality and scale of request. This could also include onsite meetings with a live walkthrough of files.

Appropriate Skills and Knowledge

The managing agent shall ensure the personnel conducting the reserving analysis have appropriate skills and knowledge of both reserving techniques and market issues impacting on reserving decisions.

Managing agents should be clear on the roles and responsibilities within the reserving procedure. Terms of reference for each function involved in the reserving process are expected.

In view of the importance of syndicate technical reserving teams to Lloyd's oversight of the market's reserve strength, Lloyd's must be notified of any prospective change in the leadership of the team.

Justification and validation

There is no prescribed structure for the reserving procedure. The Board must take its own view on ensuring a robust procedure is in place, including justification and validation of the reserves.

Usually, several methods for estimating liabilities will be considered and the final choices must be justified clearly with reasoning, limitations and uncertainty set out. The methods used by the technical reserving team should be properly validated especially when they depart from the methods normally used. In particular, Lloyd's attaches considerable weight to analyses of emerging experience against the expectation contained in previous analyses and the actions taken based on the outcome of this analysis.

There should be an appropriate and proportionate process for assumption setting, including sufficient evidencing and peer review. In addition, syndicates should ensure that the frequency of review is appropriate, taking into account materiality and uncertainty.

Where estimates are made by different parties or on different basis the syndicate is expected to rationalise the drivers of difference between these.

We additionally expect syndicates to explicitly consider inflation assumptions as part of the initial expected loss ratio ("IELR") setting process, including explicit validation of any inflation assumptions used as part of the business planning process that is relied upon as part of reserving.

Reserving adequacy should be considered at both the whole account level and class of business level to ensure appropriate information is provided to other areas showing a true view of reserves. E.g. Known surpluses in shorter-tailed classes or more mature years should not be used to offset deficiencies in longer-tailed classes or immature years.

Where the actuarial function materially changes the IBNR projection methodology or assumptions due to targeting a different point on the range of reasonable best estimate or due to changes in the case estimates setting process these must be reported to Lloyd's.

Feedback loops

The reserving procedure should incorporate feedback loops to allow comments from the Board and other committees to be reflected in the reserving work.

Guidance

The technical reserving team will be expected to know any Lloyd's and other regulatory requirements, and in particular should pay careful attention to market bulletins and the Lloyd's Valuation of Liabilities rules, issued annually and also available online on Lloyds.com.

Over the normal course of reserve oversight Lloyd's will query and make periodic requests for additional information or meetings with managing agents and/or their advisors. It is expected that staff and materials will be made available in a timely manner and access granted to external advisers where appropriate.

Lloyd's Reserving Framework will identify areas of concern through observation of trends or forward-looking risk indicators, the exposure of syndicates to thematic issues (for example by line of business) or by evidence of deficiency in syndicate processes such as those indicated by inability to supply adequate and accurate data. As per the Lloyd's risk appetite, Lloyd's has no appetite for reserve deficiencies (on a best estimate nor on a held basis) or deficient reserving processes. Deteriorations are monitored but are not the sole indicator of concerns, a "very prudent" reserve based on a poor procedure would still be a concern.

Where Lloyd's considers that a syndicate may have an inadequate reserving process or practice they will engage closely with the syndicate. Lloyd's may impose requirements on the syndicate in line with Lloyd's Reserving Framework such as more stringent reporting, (additional) independent analysis or explicit capital loads.

As part of monitoring any issue Lloyd's will meet with the syndicate or request reserving packs at quarterly or half yearly intervals, with timing to coincide with the reserving work cycle. Each quarter's reserves are important: the half year reserves form the basis of the solvency position used in coming into line in November and for interim results; the third quarter reserves are often a basis for the year end; the year end is the primary solvency analysis; and the first quarter reserves give an early indication of how a year has progressed. When engaging quarterly, Lloyd's may wish to understand and potentially influence the outcome of the exercise in good time, often before the quarter's reserves are finalised.

Senior Managers Regime

The managing agent should ensure that there is no undue influence from other senior management functions onto the actuarial function, any conflicts of interest are identified and addressed, and senior individuals remain accountable for the actions of those to whom they delegate responsibilities (including outsourcing), in line with the PRA's Senior Managers Regime .

Internal Audit

Lloyd's would expect the audit committee and internal audit to review the reserving process periodically. The frequency of the internal audit review is not prescribed but should be outlined as part of the Syndicate's risk management process; including conditions which would trigger more frequent review. It is expected that the frequency of these reviews would be higher where there have been continual deteriorations or where there have been material findings from previous audits or by Lloyd's.

Section 5: Statement of Actuarial Opinion

RS 5.1 Statement of Actuarial Opinion

Managing agents shall ensure that a Statement of Actuarial Opinion (SAO) is obtained

Managing agents shall ensure that:

- the SAO is provided annually in respect of each open year of a syndicate;
- the SAO complies with the latest Lloyd's Valuation of Liabilities rules;
- the SAO results are considered by the Board or its' nominated Committees; and
- there is an appropriate relationship between figures underlying the SAO work and those reported to Lloyd's in solvency returns.

Lloyd's requires a Statement of Actuarial Opinion (SAO) to be provided by a suitably qualified actuary in respect of each open year of every syndicate. Suitable qualification includes holding a relevant practicing certificate issued by the Institute and Faculty of Actuaries ("IFoA"). The latest criterion including qualifications for practicing certificate actuaries are described on the IFoA's website.

The SAO must comply with the latest Valuation of Liabilities Rules, and any related requirements, issued by Lloyd's.

Managing agents should ensure a process for ongoing SAO provision is in place, and this process has clear ownership. Historical provision of a SAO is not evidence of the existence of a process to ensure its provisions going forwards.

Managing agents should provide the SAO results to the Board for consideration. They should also ensure there is a mechanism for the Board to provide any feedback resulting from consideration of the SAO to both the reserving team and the SAO provider. This should be provided in sufficient time such that any resulting changes can be actioned prior to submission of the SAO and finalisation of any results.

Lloyd's will use the SAO to assess reserve margins and profit in the unearned premium reported by managing agents in solvency returns. Managing agents should ensure that these submissions are consistent with the SAO where appropriate, in line with the latest Lloyd's guidance.

Lloyd's may ask for data to be provided to the SAO provider, so they can be included in submissions to Lloyd's. Managing agents must provide this information to the SAO provider in a timely manner for onward submission.

Managing agents should consider the merits of rotation of the SAO actuary periodically. It is expected that documentation on the rationale of the appointment is available should the same individual sign the SAO for more than four consecutive years.

Section 6: Documentation

RS 6.1 Documentation

Managing agents shall have an appropriate documentation associated with the reserving process.

Managing agents shall ensure that documentation associated with the reserving process and results is complete and in accordance with Technical Actuarial Standards other professional guidance.

In addition to the formal submissions required Lloyd’s may request copies of any item of documentation related to the reserving process.

Documentation should include both the processes involved in the reserving work and reporting on results. The former is expected to include terms of reference for the roles/functions involved and documentation of the processes to be followed.

There must be appropriate disclosure to auditors and SAO-signing actuaries and the documentation should show what has been disclosed and how. Actuaries will have to meet the various requirements of the actuarial standards, and it is also expected that non-actuaries providing reserving advice to the Board would adhere to equivalent standards.

It is expected that different levels of documentation, for example detailed reports on technical procedures compared to output prepared for the Board, will take account of their audience and be tailored appropriately.