LLOYD'S

# Lloyd's Minimum Standards
# MS3 – Price and Rate Monitoring

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# Contents

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## 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

**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.

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

**Lloyd's leader (underwriting)** – the first or only Lloyd's syndicate on a slip/contract and/or a syndicate that has authority to bind other syndicates to a risk.

**Follower** – a syndicate participating on a risk other than the Lloyd's Leader.

**KPIs:** Key Performance Indicators

**PMDR**: Performance Management Data Return

**RARC:** Risk Adjusted Rate Change

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

**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.

**Technical Premium:** The price for each risk at which the Managing Agent expects to deliver the long term required return on allocated capital.

**The Board:** Where reference is made to the Board in the standards, Managing Agents should read this as the Board or appropriately authorised committee. In line with this, the matters reserved for the Board under the Governance Standard should be considered in order to evidence appropriate full Board discussion and challenge on the materials items.

**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 Standards

## PRM 1.1 – 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;
- there is a direct link between the written Risk Appetite, the Syndicate Business Plan and pricing parameters; and
- there is a written Pricing Policy which provides a clear expectation of pricing levels and an 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 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;
- Technical 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.

**Best Practice Pricing Framework (AWAITING PUBLICATION)**

Lloyd's have developed a new Best Practice Pricing Framework (BPPF). This is the framework assessment designed to give Lloyd's and its key stakeholders confidence that syndicates have in place appropriate, proportionate and well understood pricing processes which are being used in key decision making. Lloyd's will use the results of their assessment to inform their interaction with syndicates. The Framework defines Best Practice, with an aim of raising market standards across technical pricing, and portfolio management. The finalised Framework will provide greater transparency around Lloyd's supervisory reviews of pricing and related oversight. The Framework should also provide a useful reference for Managing Agents to assess for themselves the pricing capabilities of their syndicates/syndicate classes.

The BPPF will assess syndicates using the combination of operational Maturity and risk Materiality elements. The (draft) Maturity framework contains the following sections.

- Data and Infrastructure
- Technical (pricing models)
- Application (of pricing models) – By underwriters; and to other business functions
- Culture and Governance

The Materiality Assessment will utilise existing Lloyd's reporting. This includes, but is not limited to, gross premium volumes, premium growth and proportion of lead vs follow business.

The combination of Maturity and Materiality is the 'Appropriateness' assessment, as to whether a Syndicate has appropriate Maturity given its level of Materiality.

Lloyd's BPPF assessments will be categorised as reflecting either 'Basic', 'Intermediate', 'Established' or 'Best Practice' level characteristics. Leaders pricing capabilities are expected to align more towards the 'Established' or 'Best Practice' characteristics of the Framework, particularly on material data-rich classes where reliable data is available.

**Required Evidence to Lloyds**

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

## PRM 2.1 – Overarching 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 calculated for each contract (risk or portfolio) written, taking into account internal expenses, reinsurance and acquisition costs as appropriate;
- pricing is informed by experience and exposure data (if available/reliable), and not only by benchmarks and expert judgement, within a structured process or model;
- the pricing process demonstrates the expected loss ratio for each contract (risk or portfolio), with an explicit split between attritional, large and catastrophe losses where relevant;
- there are written guidelines in place to assist the underwriter in using the process/model, including the escalation process for any deviations;
- the rationale for underwriting and pricing of each contract (risk or portfolio) is recorded;
- models and assumptions are reviewed, and recalibration considered, at least annually by personnel with relevant experience (e.g. underwriters and/or actuaries) to ensure appropriate calculation of Benchmark and Technical premiums; and
- there is an established feedback loop on pricing model development and assumption setting to ensure they are updated regularly to reflect most recent relevant experience.

**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 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);
- 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, whether the Syndicate is Leading or Following, 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.

The pricing methodology should include all elements of the pricing calculation, for example:

- expected loss cost;
- catastrophe 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. To understand whether this loss ratio is adequate to meet plan or long-term objectives, an understanding of how much that risk is required to contribute to non-claims costs (expenses, reinsurance, acquisition costs, profit) is also required. Depending on the size and complexity of the risks being written this may occur on a risk-specific level or non-claims costs may be managed at portfolio level and allocated to individual risk level. This understanding of expected loss ratio and non-claims cost allow calculation of Benchmark and Technical Premiums at risk level.

It is recognised that projecting loss ratio and non-claims cost at individual risk level is not always possible. Where loss ratios are projected at portfolio or another level, Managing Agents should be able to explain the rationale.

Lloyd’s' expects Managing Agents to use a structured model or process to price each contract (risk or portfolio) pre-bind across all underwriting teams, particularly when leading. The model or process used should capture appropriate data (with recognition of any data limitations) to support the pricing analysis.

**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 Premium information is required by Lloyd’s for both new and renewed business. Managing Agents should have a clearly defined Benchmark Premium for each risk and/or portfolio for all lines, territories and segments, and where appropriate separately break out:

- By layer – when quoting for multiple layers in the same XOL programme
- By peril – for example, separating perils for large Property driven cat-exposed multi-location exposures

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]

**Technical Premiums**

Although Lloyd’s does not collect returns prepared on the basis of Technical Premiums, Managing Agents should have a Technical Premium for all lines, territories and industry segments from where most of the premium originates.

The Technical Premium is the price for each risk at which the Managing Agent expects to deliver the long term required return on allocated capital. The Technical Premium should take into account all costs associated with writing a risk (including cost of claims, expenses, commission, reinsurance) and be independent of the underwriting cycle and market conditions. Where Technical Premiums are projected at portfolio or another level, Managing Agents should be able to explain the rationale.

There should be alignment between the calculation of Benchmark and Technical Premiums. At its simplest, the difference between the two will be the profit expectation. Benchmark Premiums are calibrated to deliver the profit in the business plan (based on Gross Ultimate Loss Ratio in the plan). Technical Premiums are calibrated to deliver the long term required return on capital. For example, in a hard market, the Benchmark Premium is likely to be higher than the Technical Premium. Other components of premium will differ between Benchmark and Technical Premiums depending on pricing granularity and approach by Managing Agents.

Managing Agents should understand the contribution each risk is making to both Benchmark and Technical Premiums in order to actively manage their portfolios, but they may choose which pricing definitions are required at point of sale in order for frontline underwriters to manage day-to-day underwriting. They may rely on Benchmark loss ratios, comparison to Benchmark or Technical Premiums, or other metrics but the comparison of Actual to Benchmark and Actual to Technical is important to understand. Actual Premium / Benchmark Premium is a key forward looking metric as to whether a Syndicate will meet its current plan. Actual Premium / Technical Premium will indicate long term profitability.

**Excess layer pricing**

The pricing of excess of loss business should be supported by proven actuarial techniques and, where appropriate, reflect ground-up experience and exposures for a given programme (if available), and not only the historical experience of the excess layer.

**Pricing for Attritional, Large and Catastrophe 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.

**Non-claims cost allocation**

There should be an explicit allocation of non-claims costs (e.g. admin expenses, acquisition costs, reinsurance and the cost of capital) to each risk underwritten. The Managing Agent should periodically monitor such allocated components of premiums written in aggregate against actual expenses to identify deviations and trigger recalibration of the pricing models. Exception reports should be run which demonstrate oversight of contracts that do not include adequate allowance for these costs.

**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 recalibration should be undertaken by personnel with relevant experience e.g. underwriters and actuaries.

Pricing models which underpin material segments in class should be validated at least once per annum. Validation is expected to comprise a recalibration of pricing parameters against Syndicate Business Plan, Risk Appetite and Strategic Plan. Validation should be undertaken from the ground-up, and should also include

- Review of actual Benchmark Price Adequacy
- Review of model consistency and coverage in respect of perils to which the class is exposed
- Rebasing of base rates against claims experience
- Review of rating factors and rating parameters
- Non-risk cost allocation

Pricing parameters should be regularly updated to reflect analysis of actual experience and should be benchmarked against market data. 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.

**Feedback loop**

Model performance should be monitored to identify where fundamental assumptions diverge from actual experience, triggering pricing model review and update.

If assumptions used in pricing models and capital models are different, the reasons should be properly understood and documented.

**Written Guidelines**

Managing Agents should have 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 or aspects of the model (e.g. exposure v frequency) should be used to inform pricing and support underwriting for each class of business;
- 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;
- How to assess and measure Benchmark Price Adequacy (Actual versus Benchmark Price).

To support the written guidelines, Managing Agents should 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.

**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.

**Required Evidence**

- Pricing tools and models; and
- Written Guidelines.

## PRM 2.2 – Pricing Methodology for Delegated Authority Business

Managing Agents shall have appropriate pricing methodologies for each managed syndicate. In addition to their overarching pricing methodology (PRM 2.1), syndicates writing delegated authority business are expected to have the capability to price each contract (risk or portfolio) and quantitatively assess its expected performance prior to acceptance.

Managing Agents shall ensure that:

- the pricing approach, philosophy and expected performance of any third party is understood and aligned to their pricing policy, risk appetite and business plan before entering any delegated underwriting agreement;
- when leading Coverholder business, they have a strong understanding of the underlying pricing methodologies, processes and data, and that these are monitored closely with issues raised expediently with the Coverholder as appropriate;
- all delegated authority contracts stipulate the appropriate granularity and frequency of performance and pricing information to be shared with all participants; and
- actual performance, risk-adjusted rate change and price adequacy is kept regularly under review with any material variances reflected in revised performance forecasts.

This section is intended to apply to delegated authority business including where a syndicate is leading a line slip or consortium or writing a portfolio of risks. In addition to the above standard, all Managing Agents writing delegated authority business are required to follow the standards relating to delegated authority set out in MS2 (Underwriting and Controls) and MS9 (Customer).

**Quantitative assessment**

Managing Agents should price all delegated authority arrangements pre-bind. The assessment of price should take into account the projected future claims and expenses associated with underwriting the portfolio.

Allocation of premium to external expenses should include an assessment of how acquisition costs are commensurate with any services being delegated.

Internal expenses may include allocation of costs associated with, for example, technology requirements, or the operational cost of servicing referrals.

**Understanding of pricing approach**

Where the pricing of underlying risks is delegated to a third party, each Managing Agent is expected to ensure that this approach, and the associated costs, is aligned to their own Pricing Policy, Syndicate Business Plan and Risk Appetite. This assumed understanding should be proactively monitored through the lifecycle of the contract and reviewed at appropriately frequent checkpoints (e.g. annually at renewal).

Leaders are expected to exert their influence and control over the pricing approach and execution by the coverholder through:

- A clear understanding of the pricing methodology. Where pricing rates are provided by the Leader, the ability to change rates quickly as required.
- Clearly documented expectation for the use of pricing models by the coverholders
- Authority framework governing pricing rate changes and the use of commercial discounts

**Binders, Line slips and Consortia**

Leaders and Followers of binders, consortia and broker line slips (including facilities, covers and programmes) are expected to ensure that each delegated authority contract stipulates the appropriate granularity and frequency of performance and pricing information to be reported to all participants e.g. relating to premium, claims, expenses, exposures, risk-adjusted rate change. It is the Leader's responsibility to ensure that this information is provided in line with the provisions in the contract. The flow of this information is critical for all participants to be able to monitor each of these portfolios and to maintain accurate records.

While Leaders should review the information for each delegated authority at least quarterly, a risk-based approach should be adopted regarding the extent of review.

Where actual performance, product mix or rating conditions deviate adversely against initial forecasts, the Leader should take appropriate and timely action to mitigate the impact on performance e.g. by amending rating schedules. Management controls should be in place to ensure that reviews are conducted regularly throughout the period of the contract, and not solely at renewal.

Lloyd's recognises that, currently, the data quality for delegated authority business is variable across the market and the requirement for regular information reviews may create some challenges. However, there is a need for better quality performance data and this will be assisted by the development of DA SATS etc. In the meantime, Leaders and Followers should ensure that systems are updated regularly to ensure performance forecasts, risk-adjusted rate change and price adequacy assumptions reflect the latest position. Wherever possible, information about the actual performance and risk-adjusted rate change should be based on good quality, timely management information from the delegated party. Where this is not yet possible, Managing Agents should use expert judgement informed by their discussions with the delegated party, broker and/or Leader to keep forecasts up to date.

## PRM 3.1 – Price Adequacy and Rate Change Management & Monitoring

Managing Agents shall have effective price adequacy and rate change management and monitoring in place covering all sources of business 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;
- there is measurement of the difference between the actual premium charged and the Benchmark and Technical premiums established by the 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 regarding the quantification of pricing movements and benchmark price adequacy to ensure consistency of approach between underwriters; and
- the outcomes of rate change and price adequacy monitoring and exception reporting feed into Managing Agents portfolio management processes.

**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 will:

- Record the various elements of the pricing calculation for each risk (calculated at individual risk, portfolio or other appropriate level);
- Monitor the difference between the Benchmark price and the actual price at suitable levels (e.g. 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;
- Monitor pricing movements against the previous period(s) of insurance In respect of renewals;
- Update RARC movement on all delegated authority placements (binders/lineslips/consortia/other) at least quarterly (i.e. when monthly/quarterly bordereau is received);
- Provide written guidance for underwriters, setting out how they are to record and quantify pricing movements so as to ensure consistency of approach between underwriters;
- Incorporate a regular review process to ensure that the input data is accurate, consistent and reliable;
- Allow 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; and
- Provide for analysis of pricing movements across all sources of business, including open market and delegated authority.

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]** – http://www.lloyds.com/pmdr

**Potential Evidence**

- PMDR information;
- Written Guidelines.

## PRM 3.2 – 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 and that the assumptions and methodology remain reasonable;
- the level of data captured and stored during underwriting is reviewed against the requirement to update the pricing assumptions and results;
- 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 on the following link:

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

### 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.