LLOYD'S

Lloyd's Minimum Standards MS7 – Reinsurance Management and Control

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MS7 – Reinsurance Management & Control

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.

Management guidance

The remainder of each section consists of guidance which 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

ERM: Enterprise Risk Management

ILW: Industry Loss Warranty

ORSA: Own Risk and Solvency Assessment

QMA: Quarterly Monitoring Return – Part A

QMB: Quarterly Monitoring Return – Part B

Related Party: A related party shall mean:

- Any company within the same group as the managing agent
- Any company within the same group as a corporate member of the syndicate which has a syndicate premium income of more than 10% of the syndicate allocated capacity
- Any company which has two or more directors in common with 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 insurance special purpose vehicle company where the key management services are undertaken by persons who are employed by a company that meets any of the points 1 to 3, where those persons have authority and responsibility for planning, directing and controlling the activities of the insurance special purpose vehicle company, whether or not they are a formally recognised as directors or officers of the insurance special purpose vehicle company.

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

SRS: Syndicate Reinsurance Structure return

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.

MS7 – Reinsurance Management & Control

RI 1.1 Reinsurance Strategy & Planning

Managing agents shall have a clear and comprehensive Reinsurance Strategy and Purchasing Plan for each managed syndicate.

Managing agents shall ensure that the Reinsurance Strategy and Purchasing Plan:

- is agreed by the Board;
- is subject to regular review and challenge;
- takes into account the syndicate's underwriting strategies and appetite for retained insurance risk;
- reflects the nature, scale and complexity of the syndicate's reinsurance arrangements and business protected;
- includes a clear strategy for the selection and approval of all reinsurance counterparties;
- recognises the potential financial, business and contractual risks and potential conflicts of interest;
- considers and complies with all Lloyd's published supplemental requirements and guidelines;
- considers and complies with all applicable external regulatory and accounting requirements and guidelines.

It is accepted that the managing agency Board may delegate authority to committees or individuals for specific elements of the plan formulation, review and agreement. In such circumstances the scope of authority provided to committees and / or individuals should be clearly documented.

A syndicate’s Reinsurance Strategy should be reviewed by the Board regularly. We would recommend every 3-5 years.

A syndicate’s Reinsurance Purchasing Plan should be reviewed annually.

The documented Reinsurance Strategy should outline the syndicate’s philosophy, business drivers and objectives for the purchase of reinsurance.

It should outline how the Reinsurance Strategy is expected to support the syndicate’s risk appetite, impact its profitability, and contribute to its capital strategy.

It should cater for the syndicate’s appetite for per risk losses, per event losses, and aggregate losses, and this should be reflected in the scale, breadth and attachment of the reinsurance purchased.

We would expect the key objectives, design criteria and business considerations to be expressed within the Reinsurance Strategy and Purchasing Plan documents where appropriate, examples of such include but are not limited to:

- The proportion of risk to be ceded;
- The proportion of income to be ceded;
- The setting of retention levels (monetarily / probabilistically); Per Risk, Per Event, Aggregate (both initial and in excess of the reinsurance protections);
- The setting of “From Ground Up” and programme limits (monetarily / probabilistically); Per Risk, Per Event, Aggregate;
- The setting of horizontal covers, such as reinstatements, aggregate limits etc.;
- Defining the acceptable and unacceptable types and forms of reinsurance cover and structure;
- Defining contract wording minimum requirements, e.g. what the acceptable and unacceptable levels of gap in cover are, and the associated exclusions, restrictions & limitations, and legal construction;
- Defining core / essential and non-core / non-essential reinsurance protections;
- Defining whether the reinsurance protection is designed to protect profitability / earnings, capital, reputation etc., or a combination of all; and
- The setting of reinsurance commission expectations.

Specific Lloyd's requirements and guidelines exist relating to Reinsurance Leverage. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

The Reinsurance Strategy and Purchasing Plan should also include reference to the acceptance / selection criteria for reinsurers, intermediaries and collateral providers, including but not limited to:

- Requirements of the relationship with reinsurance counterparties, e.g. technical support, pure capacity etc.;
- Business model features for acceptable reinsurance counterparties, e.g. structure, strategy, traditional markets versus non-traditional etc.;
- The potential risks associated with over reliance or financial dependency on individual reinsurance entities or groups;
- The minimum level of acceptable financial strength of counterparties including a clear definition of how this should be assessed; i.e. minimum financial strength rating, minimum solvency ratio / value; and
- The acceptable levels of counterparty concentration, per loss, per event, and in aggregate, that reflects the financial breadth of the reinsurance counterparties, i.e. minimum asset &/ or capital value, liquidity.

Specific Lloyd's requirements and guidelines exist relating to Reinsurer Selection. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

The content and level of detail within the documented Reinsurance Strategy and Purchasing Plan should reflect the level of structural and coverage complexity, financial materiality and breadth and diversity of the business protected. It should be tailored for each syndicate managed.

The guidance under RI 1.3 provides more detail on the type and nature of the risks that should be considered.

The Reinsurance Strategy and Purchasing Plan should cater for all relevant regulator and Lloyd's byelaws, guidelines, and operating & reporting requirements, it being accepted that these will be subject to change from time to time.

The Syndicate Business Forecasts (SBF) submission for each managed syndicate should include details of the syndicate reinsurance strategy and plan for the planned year of account (YOA) and include details of key features and all material assumptions and dependencies, in accordance with the published SBF instructions.

A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

RI 1.2 Reinsurance Strategy & Plan, Implementation & Monitoring

Managing agents shall ensure that the Reinsurance Strategy and Purchasing Plan are followed, implemented and kept under regular review for each managed syndicate.

Managing agents shall ensure that:

- existing and planned reinsurance protections are consistently and appropriately considered within the business planning, exposure management, accounting and capital setting processes;
- any material amendments to the Reinsurance Strategy and Purchasing Plan are approved by the Board; and
- approval is requested in advance from Lloyd's for any deviations to the syndicate's planned or actual reinsurance arrangements that would materially impact the syndicate's Syndicate Business Forecast and / or capital requirements.

A common understanding of the existing and planned reinsurance protections should be held by all appropriate business functions, in particular those involved in calculating or estimating the benefit and risks associated with the syndicate's reinsurance protections.

The opinion and calculated benefits and risks associated with the syndicate's reinsurance protections across the various business processes should be consistent, with any variance documented and rationalised.

If any material terms, conditions, restrictions and exclusions are not explicitly catered for in the modelling or calculation of any benefits and risks, then these should be highlighted and the impact of this approach should be clearly documented.

If the method of calculating or estimating the benefit arising from reinsurance protection(s) has been simplified in any business process so that it no longer fully reflects the actual structure and coverage of the reinsurance contract, this method and any associated assumptions should be clearly documented and appropriately validated and tested by the managing agent.

It is accepted that multiple directors may have responsibility for different aspects of the implementation, operation and review of the syndicate's Reinsurance Strategy and Purchasing Plan; it is therefore important that roles and responsibilities are clearly defined.

Any Board pre-agreed variances / tolerances to the Reinsurance Strategy or Purchasing Plan are to be recorded. Approval of material amendments should be recorded in writing.

Any amendments or changes to existing or planned reinsurance which could, or will, materially impact or change the financial performance of the syndicate or the capital required to support open years of business should be assessed in a timely manner. This would include but not be limited to:

- Alteration;
- Re-negotiation;
- Repudiation;
- Commutation;
- Termination; and
- Actual or modelled erosion of protection (see also specific Shared Reinsurance).

RI 1.3 Reinsurance Controls & Risk Framework

Managing agents shall have an effective systems and controls framework to support the management of all aspects of the outwards reinsurance for each managed syndicate.

Managing agents shall ensure that:

- there is a nominated director(s) with accountability for the reinsurance systems, controls and risk framework;
- appropriate written policies and procedures are in place to allow effective management of reinsurance placements and administration, and reinsurance recoveries / assets;
- roles, responsibilities and reporting lines, including reinsurance purchasing and signing authorities, are clearly defined, approved by the Board and reviewed annually;
- risks relating to existing or planned reinsurance are identified, quantified and managed appropriately, including specific consideration of contract and counterparty risks, and associated liquidity risk;
- regular analysis and review is undertaken of the effectiveness of existing and planned reinsurance protections, including specific consideration of coverage erosion/exhaustion, and in particular from shared reinsurance arrangements where applicable;
- compliance with Lloyd's published supplemental requirements and guidelines are monitored and reported;
- compliance with applicable external regulatory and accounting requirements are monitored and reported;
- at required intervals, prescribed data returns and information submissions are prepared and submitted to Lloyd's;

- amendments to existing reinsurance arrangements are evaluated and those with a material impact on the syndicate are reported to relevant business areas, committees and individuals in a timely manner;
- reinsurance information is accurately recorded and reported; and
- outwards reinsurance contracts comply with the principles of Contract Certainty.

The content and depth of the written policies and protocols shall reflect the syndicate’s Reinsurance Strategy and Purchasing Plans.

The sophistication of the written procedures and processes should be proportionate to the nature, scale and complexity of the reinsurance arrangements and the business and operations they are protecting.

We would expect that the procedures to include but not be limited to the following activity:

- Pre-placement administration and project management;
- Post- placement administration, reporting and compliance with contractual terms and conditions;
- Protocols and processes that ensure that reinsurance contracts do not present undue levels of liquidity risk;
- Risk and materiality-based management of reinsurance debtors;
- ‘Document Management’ policy and procedures to ensure that all reinsurance contracts and related documentation be retained until all Reinsurers actual or potential liability under the reinsurance contract(s) has ceased;
- The ability to identify whether a risk underwritten by the syndicate is protected by any form of reinsurance (i.e. treaty or facultative);
- Cater for Lloyd's supplemental requirements and guidelines
- Cater for applicable external regulatory and accounting requirements and guidelines.

Roles and Responsibilities

The roles and responsibilities for the management of the documented policies, procedures and operational systems and risk management controls relating to reinsurance arrangements should be clearly documented, with nominated director(s) assigned accountability for their effective maintenance & operation.

The roles, responsibilities and authorities of each business area, committees and individuals involved in the purchase and administration of reinsurance protections and the recoveries there from, should be clearly defined and documented.

The managing agent’s Board should define the level and scope of delegated authority to be granted. Each individual who has been delegated authority should have a written authority document setting out the scope and extent of the reinsurance authority they have been granted.

When delegating authority, the managing agent’s Board shall give consideration to the following topics:

- Whether the individual has been granted the legal authority to sign / execute reinsurance contracts on behalf of the syndicate;
- Whether the individual has authority to negotiate and approve commutations, novations or other reduced or negotiated settlements of reinsurance recoveries; and
- Whether the individual is permitted to delegate in full or in part the authority they have been granted.

It is the responsibility of the managing agent's Board to ensure that that those with authority to purchase reinsurance have the necessary skills and capabilities, and purchase reinsurance in accordance with the authority granted and the approved plan.

Risk relating to existing and planned reinsurance

As outlined in RI 1.1 the documented Reinsurance Strategy and Purchasing Plan should identify and quantify any potential risks or material dependencies inherent within the approved Strategy or Purchasing Plan. The acceptance of these risks and dependencies should be clearly documented along with the rationale for acceptance and the risk management / mitigating actions to be taken.

We would expect that the following high-level elements to be considered as a matter of course:

- The risks of reduced or non-payment by reinsurance counterparties, be they reinsurers, intermediaries or collateral providers;
- The risk of reinsurance premiums exceeding the budgeted cost;
- The risk that reinsurance commissions received do not meet expectations;
- The risk of operational/administrative costs exceeding the budgeted cost; and
- The risk of reinsurers withdrawing or restricting capacity.

The causes of these risks are numerous, and their materiality will vary depending on the specifics of the syndicate's reinsurance arrangements, as such we would expect the syndicate's risk framework to be tailored to reflect the specifics of the syndicate.

The following is a non-exhaustive list of examples of the causes/risks which we would normally expect to be considered, in the formulation of the Reinsurance Strategy, the highlighting of dependencies/risks within the Purchasing Plan and as part of ongoing risk monitoring:

- Contract dispute;
- Contract ineffectiveness;
- Cover exhaustion/erosion (see also separate guidance for Shared Reinsurance arrangements);
- Modelled loss not covered by reinsurance;
- Breach of terms and conditions or mid-term termination;
- Reinsurance counterparty unwilling to pay / negotiated settlement / commutation;
- Reinsurance counterparty unable to pay (e.g. sanctions, financial impairment, financial failure);
- Inability to obtain planned cover;
- Reduction in value or failure of Collateral arrangements (see separate section below);
- Material reductions in the level of ceding and/or profit commissions budgeted for;
- The divergence of reinsurance rates and original rates;
- Material reduction and or restriction in breadth of cover at no rate reduction;
- Costs to administer business exceed the reinsurance commissions received;
- Errors, omissions, misrepresentations found in reporting and / or accounting submissions; and
- File Audits / Inspection of records.

RI Contract Dispute Risk

Managing agents should consider the nature of each syndicate's reinsurance protection(s), both prospective and historic, in determining the levels of potential dispute risk present. For material reinsurance contracts Lloyd's would expect managing agents to be able form an internal risk opinion classification on their reinsurance contract wordings, e.g. Low / Medium / High / Significant.

Whether a contract presents a higher than average potential for dispute risk will depend on a number of factors. For example, the greater the volume of the following, the greater the contract risk:

- Basis risk on the recovery trigger
- High levels of conditional information provision, special acceptance &/or notification requirements
- Untested, unusual and/or uncommon clauses that have no or limited legal precedent of interpretation
- Existence of critical warranties that would void the contract

We would generally expect managing agents to regularly undertake technical and legal review of a syndicate's reinsurance contracts to ensure that the contract intent remains clear and legally effective. We would also recommend that this also considered as part of any actual triggering of terms and conditions within the contract. The frequency and depth of these reviews should reflect the financial materiality of the contract(s) and the opinion of potential dispute risk.

When making allowance for the potential risk of reduced recovery due to contract dispute we would expect syndicate to make use of any internal or externally available information / data. However, it is unlikely that sufficient data will be available to enable robust probabilistic modelling to estimate the frequency and value at risk. We would therefore expect managing agents to also consider dispute risk using deterministic stressed scenarios where appropriate. For example, the application of estimated non-recovery rates could be considered relative to the managing agent's opinion of contract dispute risk, e.g.

- Low risk contract = 1% reduction of recoveries due to dispute risk if <£…m, or 10% if >£…m
- Medium risk contract = 10% <£…m, or 20% if >£…m
- High risk contract = 25% if <£…m or 50% > £…m,
- Significant risk = 50%+.

Counterparty Risks

The level of exposure to reinsurance counterparties, be they reinsurers, intermediaries or collateral providers, and the financial, contractual and strategic strength of these counterparties should be regularly assessed and monitored. Any financial risks arising should be managed and capitalised for appropriately.

We would expect managing agents to monitor and assess the syndicate's financial exposure to reinsurance counterparties. A process should exist to allow the reporting and consideration of the level of financial exposure the syndicate has to each counterparty, be it an individual reinsurer or group of companies, intermediary or collateral providers. We would normally expect this to be evaluated in terms of the premium and exposure ceded, the face value of contracts as well as unsettled and / or modelled or expected recoveries.

The managing agent would be expected to be able to effectively monitor:

- The financial strength and breadth of its reinsurance counterparties (e.g. financial strength ratings, solvency ratios, monetary value and nature of available of assets);
- The strategic, operational and legal structure of its reinsurance counterparties and changes made to it, including merger and acquisition activity;
- Any changes in its reinsurer's strategic objectives that are material to the syndicate's reinsurance arrangements; and
- The willingness and ability of its reinsurance counterparties to settle reinsurance recoveries.

We would expect risk mitigation techniques to be considered and implemented wherever viable to manage, mitigate and control the risks identified, including:

- Appropriate key risk indicators are identified and monitored at least quarterly, and where deemed material reviewed by the managing agency Board, with actions taken where appropriate; and
- Any residual or retained risks borne by the syndicate have been quantified and incorporated into the syndicate's ERM framework and catered for in the syndicate's capital modelling, e.g. Insurance Risk, Credit Risk, Operational Risk.

Specific Lloyd's requirements and guidelines exist relating to Reinsurer Selection. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

Related Party Protocols & Procedures

Specific Lloyd's requirements and guidelines exist relating to reinsurance protections with Related Parties. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

In addition to the provision of an annual Related Party Transaction Declaration & Disclosure Return, managing agents are expected to be able to demonstrate that they have effective procedures in place and documentation explaining the protocols and processes for ensuring reinsurance transactions involving Related Parties, including between multiple syndicates managed by the same managing agent, are undertaken on an "arm's-length" basis in regards to (i) pricing, (ii) contract wording and (iii) terms of trade, so as to:

- Avoid potential conflicts of interest;
- Ensure that the suitability of the transaction for the syndicate is independently evaluated; and
- Ensure that risk transfer can be demonstrated.

Inter-syndicate reinsurance

Specific Lloyd's requirements and guidelines exist relating to inter-syndicate reinsurance protections between syndicates managed by the same managing agent, or by a related managing agent. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

Collateral Arrangements

Collateralisation of reinsurance contracts is a common way to mitigate counterparty credit risk and aid liquidity management. However collateral arrangements are not risk-free as they inherently present the potential for non-payment or non-release of the collateral. The level of risk varies significantly depending on the nature of the arrangement. The headline causes can be categorised as:

- contract dispute / failure;
- inadequate value; and
- delayed payment / inability to withdraw funds.

Each of which can be triggered by a wide range of specific causes.

Where the use of collateral is material for a syndicate we would expect managing agents to have specific acceptance criteria, and collateral management processes and procedures in place.

Lloyd's does not currently impose or set restrictions in regard to the type and nature of the collateral arrangements that syndicates can have to support Outwards Reinsurance arrangements, however the guidance below relating to LOC providers should be noted. In general terms Lloyd's considers reinsurer exposures which are supported 100% by low risk forms of "held-collateral" to be financially strong, on the proviso that they are managed effectively.

Collateral arrangements take many types / forms (see below), and can be contractually structured as either pre-loss or post-loss "held- collateral" (i.e. currently in place), or as a contractual requirement to post collateral if specific contractual criteria are triggered "Future Collateral".

To be considered "held-collateral" it must be in place and the reinsured must have a clear legal / contractual right to be able draw on the collateral. A condition in a reinsurance contract that requires a reinsurer to post collateral in the future is not considered to be "held".

Each type / form of collateral can be used to either settle reinsurance recoveries at the point of invoice, or as financial guarantees that can be drawn upon in the event that the counterparty does not comply with the settlement / payment terms of the reinsurance contract.

Due to the bespoke nature of collateral arrangements and the inherent contractual links with the associated reinsurance contracts, Lloyd's expects syndicates to tailor how it manages the collateral to the specific characteristics and parameters of each arrangement. Lloyd's expects a syndicate's processes and procedures to take the following features and guidance into account, where applicable:

1. 'Working Collateral' is considered to be any form of collateral that has been designed to be drawn upon immediately and act as an operating 'claims' fund, that allows the Reinsured to draw from it to directly to settle a Reinsurer's contractual obligations.

2. 'Stand-by Collateral' considered to be any form of collateral that has been designed to only be drawn upon by the Reinsured if the Reinsurer has failed to meet specific contractual terms, such as failure to settle a valid claim within the contract terms of trade / credit (e.g. 60 days).

3. <u>Collateral value v. reinsurer exposure</u> the financial strength afforded by collateral can only be taken into account up to its current financial value. Any gap between the value of the held-collateral and the reinsurer's total contractual exposure will be considered unprotected by the collateral.

4. <u>Collateral exchange rate risk</u> the benefit taken for collateral arrangements that are in different currencies to the reinsurer's exposure, in part or in full, should cater for exchange rate risk.

5. <u>Future Collateral</u> arrangements are, as a general rule, not to be considered as automatically available and should not to be taken into account unless specific evaluation has been undertaken. Such arrangements include, but are not limited to:
    a. contractual rights to request collateral; and
    b. post loss or future incurred collateral funding arrangements.

6. <u>Unsegregated / Shared Collateral</u> arrangements are not normally acceptable to Lloyd's, i.e. where a single collateral arrangement / fund is being used by a counterparty as a financial guarantee for multiple beneficiaries / reinsureds for multiple exposures.

7. <u>Collateral withdrawal</u> only collateral arrangements that are payable on demand, or within acceptable terms of trade to minimise liquidity risk are acceptable to Lloyd's, e.g. 30 days.

8. <u>Acceptable credit institutions / collateral providers</u> Lloyd's does not currently impose or dictate which collateral counterparties can be used. Syndicates are expected to consider and manage associated risks as part of their usual reinsurance counterparty management processes.

9. <u>Funds / Cash Withheld</u> arrangements where the syndicate or managing agent have cash or cash equivalent 'in hand' or in a cash account are acceptable to Lloyd's. Lloyd's consider such arrangements to present little to no RI Credit Risk, subject to points 3 and 4 above. They therefore can be considered a direct offset to a reinsurer's exposure where the arrangement allows the syndicate or managing agent to draw from the cash funds to settle debt. However where such are held in a general cash account rather than in trust, then the financial failure of the credit institution they are held with should be considered. This would present Market Risk rather than RI Credit Risk.

10. <u>Cash in escrow accounts</u> where the reinsurer / sponsor, or a party representing the reinsurer or sponsor, can withdraw funds are not considered risk free and should be subject to the same considerations as "Cash in Trust".

11. <u>Cash in Trust</u> these arrangements are acceptable to Lloyd's. Lloyd's consider such arrangements, where the associated reinsurance contracts and collateral management and trust agreements have been subject to appropriate legal and regulatory scrutiny, to present modest RI Credit Risk. As the funds are in 'trust' they are not expected to be directly affected by the financial failure of the credit institution managing the trust. However, in addition to the considerations under points 3 and 4 above, the following potential risks are present so should not be considered risk-free:
    a. Contract dispute risk;
    b. Regulatory action on the trust funds, including the banking regulator treating as an asset of the credit institution rather than the beneficiary / reinsured; and
    c. Delayed payment / liquidity risk.

    Syndicates should form an evidence-based opinion of the financial strength of the collateral arrangement - it being noted that Lloyd's would expect such to be subject to a maximum financial strength equivalent to that of 'AAA' rating.

12. Cash equivalents in Trust (other than government financial instruments which are considered below) to be considered ‘equivalent’ to cash the assets must be immediately convertible to cash with limited to no risk of devaluation in value. Such arrangements are acceptable to Lloyd’s. Lloyd’s consider such arrangements, where the associated reinsurance contracts and collateral management and trust agreements have been subject to appropriate legal and regulatory scrutiny, to present modest RI Credit Risk. As the funds are in ‘trust’ they are not expected to be directly affected by the financial failure of the credit institution managing the trust. However, in addition to the considerations under points 3 and 4 above, the following potential risks are present so should not be considered risk free:
    a. Contract dispute risk;
    b. Regulatory action on the trust funds, including the banking regulator treating as an asset of the credit institution rather than the beneficiary / reinsured; and
    c. Delayed payment / liquidity risk.

    Syndicates should form an evidence-based opinion of the financial strength / risk of the arrangement - it being noted that Lloyd’s would expect such to be subject to a maximum financial strength equivalent to that of ‘AAA’ rating.

13. Assets in Trust (other than government financial instruments which are considered below) such arrangements are in general terms acceptable to Lloyd’s. Lloyd’s considers such arrangements, where the associated reinsurance contracts and collateral management and trust agreements have been subject to appropriate legal and regulatory scrutiny, to present variable levels of RI Credit Risk. As the assets are in ‘trust’ they are not expected to be directly affected by the financial failure of the credit institution managing the trust, however in addition to the considerations under points 3 and 4 above, the following potential risks are present so should not be considered risk free:
    a. Contract dispute risk;
    b. Regulatory action on the trust funds, including the banking regulator treating as an asset of the credit institution rather than the beneficiary / reinsured;
    c. Delayed payment / liquidity risk; and
    d. Devaluation / market risk on the individual assets – this will vary significantly depending on the specific nature, investment ratings and diversity profile of the underlying assets.

    Syndicates should form an evidence-based opinion of the financial strength of the collateral arrangement - it being noted that Lloyd’s would expect such to be subject to a maximum financial strength equivalent to that of an ‘A’ rating.

14. Government financial instruments in Trust these can take various forms and would fall under the broader definitions of either “Cash equivalents in Trust” or “Assets in Trust”, so the aforementioned risk considerations for these arrangements also apply. As above syndicates should form an evidence-based opinion of the financial strength of the collateral arrangement - it being noted however that Lloyd’s would expect such to be subject to a maximum financial strength equivalent to that of the credit ratings assigned to the government / sovereign that they relate to.

15. Fixed charge: to mitigate the risk of a syndicate’s rights over assets in trust (points 11-14) being challenged in the event of the insolvency of other parties to the reinsurance contract and/or the collateral agreements, we would recommend that a legally enforceable fixed charge over these assets be put in place. Especially if the values involved are material to the syndicate.

16. Letters of Credit (LOC) such arrangements are acceptable to Lloyd’s. When in the form of a ‘financial guarantee’ rather than access to explicit assets, LOCs present different forms of non-payment risk than others forms of collateral. The wording of LOCs should not be considered as ‘standard’ and should be subject to appropriate legal and regulatory scrutiny. They will be directly affected by the financial failure of the credit institution providing the LOC. Therefore, in addition to the considerations under points 3 and 4 above, the following potential risks are present so should not be considered risk free:
    a. Financial strength rating of credit institution;

b. Domicile of credit institution and its associated government / sovereign rating;
c. Whether the LOC period matches the period of the reinsurer's exposures;
d. Whether the LOC is clean and irrevocable;
e. The notice of cancellation provisions; and
f. The law of jurisdiction.

Syndicates should form an evidence based opinion of the financial strength of the collateral arrangement – it being noted that Lloyd's expects such arrangements to be initially based on the financial strength rating of the credit institution / collateral provider, up to a maximum equivalent to that of 'AA' rating, as long as this does not exceed the government / sovereign rating for the domicile of the credit institution.

Please note that LOCs in place to support syndicate level outwards reinsurance arrangements are not considered to contribute towards Lloyd's FAL LOC provider exposure limits, as are they are contingent exposures rather than FAL assets. However, in the exceptional instances where Lloyd's makes collateralisation of outwards reinsurance exposures a requirement a LOC provider would need to pass the FAL LOC minimum rating criteria. Wherever possible the use of a LOC provider that had already exceeded Lloyd's FAL LOC exposure limits should be avoided. The use of a LOC provider which has for any other reason already been classified as an unacceptable Lloyd's FAL LOC provider would also not be permitted.

17. Parental Guarantee; these arrangements are, in general terms, not acceptable to Lloyd's, but would be considered on a case by case basis. Whilst having features similar to LOCs this form of 'financial guarantee' tends not to be supported by specific regulatory standards or banking codes and, as such, has a higher risk of being legally unenforceable.

RI Credit Risk modelling

Managing agents should use their own experience / data when considering and formulating RI Bad Debt provisions and calculating RI Credit Risk, however it is unlikely to be sufficient. Therefore, Lloyd's expects managing agents to use the following where available:

- Financial Strength Ratings (FSR),
- Non-payment impairment / default studies
- Credit ratings reports

The manging agent should also reflect reinsurer specific risks; e.g.

- Level of capital relative to liabilities including solvency / surplus ratios,
- Level of liquidity,
- Current level of aged debts or disputes,
- Investment strategy,
- Underwriting strategy and performance,
- Effectiveness of regulatory regime in the domicile.

Non-payment probability studies for use in a Reinsurance Credit Risk modelling should:

- Ideally only included (re)insurance sector companies
- Capture companies in all countries/domiciles, but at least those that match the domiciles of the reinsured's reinsurance counterparties
- Capture transitions between FSRs on a year to year basis
- Consider the probability of non-payment based on an 'event' that could trigger full or partial non-payment
- Capture the cause of the 'event', e.g. Catastrophe Losses, systemic increase in legal liability, economic downturn, reductions in liquidity or availability of credit, capital market failures
- Be based on data/study timeframe of 30+ years which is not longer than 2 years old
- Assign a probability of impairment / default against a financial strength rating (FSR) category that can be readily mapped to the FSRs that the reinsured holds for its reinsurance counterparties
- Express probabilities for timeframes that at least match the lifespan of expected reinsurance settlements

Not all studies published by the External Credit Assessment Institutions (ECAI) meet all these criteria perfectly, so the differing limitations and benefits of all need to be balanced as part of the decision-making process. The key is adopting one of the available probability studies that best caters for the above points and reflects the levels of uncertainty in the studies. A key consideration is the trigger event so it is appropriate to consider those studies which are based on the earliest trigger of potential reduced or non-payment, which is commonly the point of financial or operational impairment rather than full default.

When using FSRs and credit ratings reports as a basis for parameterising RI Credit risk default parameters, managing agents should take into account that these studies generally do not include dispute risk.

Managing agents should also test data against their own worst experiences and scenario tests. Managing agents should stipulate the basis of the default rates used (i.e. specific term) and the degree of stress applied to these rating factors to reflect the current economic environment. e.g. in an economic downturn it might not be appropriate to base the default probabilities on studies covering a period of economic growth. Default probabilities might have to be adjusted to reflect realistic levels of risk in the economic environment present.

Loss Given Default (LGD) ratios used in a Reinsurance Credit Risk modelling should:

- Ideally only included (re)insurance sector companies
- Capture companies in all countries/domiciles, but at least those that match the domiciles of the reinsured's reinsurance counterparties
- Be based on data/study timeframe of 30+ years, or if for a shorter period must include a time period that includes consideration of near term historic economic downturn or recession for the domiciles of reinsured's reinsurance counterparties
- Consider near term actual economic LGD performance/trends
- Capture the level of reduced/non-payment both before and after the point of 'impairment'
- Capture the level of reduced/non-payment by financial strength rating (FSR)
- Capture the level of reduced/non-payment triggered by correlated events, e.g. catastrophe losses, systemic increases in legal liability, sudden economic downturn, sudden reductions in liquidity &/or availability of credit, capital market failure.

Not all ECAI publish LGD studies or data sets that meet these criteria. We accept that there is limited publicly available historic statistical data for LGD rations, so we expect managing agents to also consider using, where available, actuarial studies and technical papers, and using SII Standard Formula parameters as the baseline for their considerations but to then to uplift for variability based on observed or perceived risk factors.

Lloyd's expects managing agents to apply a loss given default ratios of at least 50% for counterparties with an FSR equivalent to A, in line with SII Standard Formula, however when assigning loss given default ratios Lloyd's expects syndicates to also consider:

- Positive and negative risk features of the syndicate's reinsurers (e.g. financial strength rating, current aged debts or regulatory action)
- Positive and negative risk features of the syndicate's reinsurance contracts (e.g. contract clarity, current disagreements or disputes)
- The probability that loss given default ratios would increase under stressed scenarios, including with the scale of the unpaid recovery.

It should be noted that the loss given default ratios should be applied to the unpaid recovery at the point of default and that collateral may be taken into account, but only if the collateral has not already used as a positive risk feature when considering impairment / default probabilities.

We also expect managing agents to consider individual contract and aggregate contract concentration risk with reinsurers.

When assessing concentration risk, managing agents should also consider the extent to which reinsurance recoveries with separate legal entities that are part of the same corporate group should be aggregated.

Where a syndicate has a significant concentration to individual reinsurers and/or to a corporate group of reinsurers (including intra-group related party and intra-Lloyd's arrangements) managing agents should undertake an assessment of the impact of the reinsurance counterparty/group being unable to meet its obligations in full.

Lloyd's expects that at least the following should be considered significant concentrations by managing agents:

- In excess of 50% of the expected reinsurance recoveries at either t0 and/or 99.5th are from the concentrated reinsurer
- The reinsurance recoveries from the concentrated reinsurer are expected to exceed 20% of the syndicate's total balance sheet assets

Accordingly, Lloyd's would expect the capital charge to increase in step with the materiality of these features and be significantly higher than perhaps the stand-alone Financial Strength Rating, albeit appropriately stressed, would indicate.

At these levels Lloyd's would also expect the managing agent to be applying deterministic reinsurance concentration risk provisions over and above the modelled results, as probabilistic modelling alone can understate the level of risk due to sampling error.

Shared Reinsurance

Specific requirements and guidelines exist relating to reinsurance protections shared with other entities. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

We would highlight that whilst shared reinsurance can provide significant cost and efficiency advantages to the parties involved it also presents increased risk potential to the syndicate.

The actions / activity of the other entities could negatively influence the effectiveness of the reinsurance protection(s). The risks to the syndicate should be appropriately identified and managed, in particular the potential for contract dispute and unexpected cover erosion.

Non-standard and alternative reinsurance arrangements

Specific requirements and guidelines exist relating non-standard and alternative reinsurance arrangements. A link to Lloyd's 'Performance Management – Supplemental Requirements and Guidance' can be found in the Appendix at the end of this document.

Lloyd's consider the form and structure of reinsurance contracts to fall into one of the following broad categories:

- 'Traditional';
- 'Non-traditional', includes reinsurance products such as ILW's and other parametric or indexed covers which have a primary trigger which is not the reinsured's gross loss, or net loss (after other inuring reinsurance) , but which still have an indemnity-based trigger within the contract; and
- 'Non-standard and alternative reinsurance arrangements', includes any purported contract of reinsurance or other financial instrument which it is proposed should be treated as reinsurance by the syndicate, but which does not operate on an indemnity basis or which provides for limited, or no demonstrable genuine, risk transfer.

Regular review of the effectiveness of existing or planned reinsurance protections

Effectiveness should be considered in the context of the syndicate's:

- Insurance exposures / risks;
- Underwriting strategy;
- Business plans;
- Capital requirements; and
- Regulatory requirements and obligations.

We would recommend that the analysis and review activity features, where appropriate:

- Actuarial opinion;

- Legal opinion; and
- Regulatory opinion.

The ongoing effectiveness of Shared Reinsurance should be specifically considered – see aforementioned guidance on Shared Reinsurance.

Lloyd's and other regulatory and accounting requirements

As outlined in RI 1.1, all relevant regulator and Lloyd's byelaws, guidelines, and operating & reporting requirements should be considered and included as part of the syndicate's Reinsurance Strategy and Purchasing Plan. The level of compliance / adherence should be monitored on a regular basis and reported to the nominated director(s), and where appropriate to the Board.

Lloyd's data and reporting requirements

The managing agent is expected to be able to accurately and consistently report details of the syndicate's actual 'in-force' reinsurance arrangements, planned reinsurance arrangements and reinsurance recoverables / assets, along with the associated reinsurance counterparties, to Lloyd's in accordance with Lloyd's reporting requirements.

There are currently a number of routine scheduled reporting returns which relate to outwards reinsurance, either in full or in part, these are summarised below:

- Syndicate Business Forecast (SBF);
- Lloyd's Capital Return (LCR);
- Syndicate Reinsurance Structure (SRS);
- Quarterly Monitoring Return – Part A (QMA);
- Quarterly Monitoring Return - Part B (QMB);
- Realistic Disaster Scenario (RDS & RDL);
- Lloyd's Catastrophe Model (LCM); and
- Related Party Declaration & Disclosure.

The content and frequency of these returns are subject to review and change. Additional information or data returns both routine and specific may be requested at any time, including ad hoc market wide requests such as Major Claims Returns, and syndicate specific supplemental reporting requirements.

Amendments to existing reinsurance arrangements

Any change or amendment to an existing reinsurance arrangement should be evaluated and the financial and operational impact established. Where possible the level of financial tolerance or measure of materiality should be agreed in advance, along with an appropriate notification / referral process.

Reinsurance information recording and reporting

Reinsurance information, be it administration, effectiveness / evaluation and/or risk reporting, should be produced and monitored regularly (we would recommend at least quarterly), and be provided to the appropriate syndicate business areas, committees and individuals for review and consideration.

We would expect key information to be provided on a routine, and exception basis, to the:

- Nominated director(s) with responsibility for the implementation, operation and review of the Reinsurance Strategy and Purchasing Plan;
- Nominated director(s) with accountability for the reinsurance systems, controls & risk framework; and
- The managing agency Board.

With actions taken and documented where appropriate.

Contract Certainty

The syndicate's minimum contractual and cover requirements should be clearly defined in advance of placement / purchase, with any pre-agreed variances / tolerances clearly documented.

At the point of the inception or renewal of a reinsurance contract we would expect it to be clear what cover is in place and how this compares to the syndicate’s approved purchasing plan and minimum requirements. Shortfalls or gaps should be notified to the appropriate nominated director(s), and Board where material.

Reinsurance contracts and supporting documentation should clearly set out the conditions of cover, and wherever possible;

- Be drafted and reviewed taking into account technical, legal, accounting and underwriting input;
- Be in place prior to inception / renewal;
- Identify and quantify any variances, gaps or shortfalls in cover compared to the syndicate's requirements; and
- Be reviewed and signed by authorised personnel.

RI 1.4 Reinsurance Controls & Risk Framework, Audit and Review

Managing agents shall audit and review the effectiveness of the systems and controls in place to manage outwards reinsurance for each managed syndicate.

Managing agents shall ensure that:

- the reinsurance control and risk framework is subject to regular and appropriate internal audit review;
- there is regular exception reporting to identify potential variances or control failures and these are investigated and escalated as appropriate;
- a representative range of reinsurance protections purchased on behalf of the syndicate are checked regularly to ensure consistency of approach with the documented reinsurance policies & procedures;
- a representative range of risks underwritten by the syndicate are checked regularly to ensure that they comply with any reinsurance terms and conditions which may apply; and
- a representative range of claims are checked regularly to ensure that reinsurance recoveries are made appropriately.

We would recommend that routine reviews of the reinsurance control and risk framework be undertaken at around 2-3 year intervals. The actual frequency is down to the managing agent to decide, but should reflect:

- The scale of materiality / dependency the syndicate has on outwards reinsurance;
- The complexity of the reinsurance arrangements in place;
- The materiality of any change in reinsurance arrangements, procedures, personnel or responsibilities; and
- Whether previous reviews and / or actual experience has identified weaknesses in the control and risk framework.

We would recommend that regular exception reporting to identify variances and control failures should be undertaken at least twice yearly.

The volumes and frequency of reinsurance protections checked back to the reinsurance policy and procedures should be proportionate to the volume of reinsurance contracts purchased. It should include both treaty and facultative protections. We would recommend that this should be undertaken at least annually.

The volumes and frequency of risks written that are checked against reinsurance terms and conditions should be proportionate to the volume of risks written and the volume of reinsurance contracts purchased. It should include both treaty and facultative reinsurance protections. We would recommend that this should be undertaken at least annually.

The volumes and frequency of claims checked to ensure reinsurance recoveries are made appropriately should be proportionate to the volume of reinsurance recoveries and the volume of reinsurance contracts purchased. It should include both treaty and facultative reinsurance protections. We would recommend that this should be undertaken at least annually.

Examples of documentary evidence pertinent to ALL Reinsurance Minimum Standards that Lloyd’s may request from time to time:

- Outwards Reinsurance Strategy document(s) at whole account or class of business level;
- Outwards Reinsurance Purchasing plan(s) at a whole account or class of business level;
- Presentations made to the managing agent Board, director(s), committees, business areas or individuals in respect of outwards reinsurance and the associated minutes;
- Organisational structure charts;
- Operational process flow charts;
- Referral procedures;
- Reinsurance Policy and Procedure manuals;
- Risk appetite statements;
- Terms of Reference, agenda and minutes from committee meetings;
- Authority documents;
- CVs for key personnel;
- Reinsurance structure, design and pricing evaluation reports;
- Capital setting methodology documentation, validation reports and output reports;
- Reinsurance placement debrief reports;
- Exposure management modelling methodology documentation, validation reports and exposure reporting;
- Actual v plan monitoring reports;
- Operational reinsurance reporting;
- Exception reporting;
- Reinsurance schematics / pictorials;
- Sign-off procedures and records for Lloyd’s returns;
- Risk reporting;
- Syndicate’s ORSA;
- Reserving and pricing policies;
- Outwards reinsurance recovery plans / targets for current financial year;
- Reinsurance counterparty assessment and acceptance criteria, including concentration and exposure summaries;
- Bad Debt and Write-off policies;
- Security Committee terms of reference, agendas, reports and minutes;
- Terms of Business Agreement documents;
- Reinsurance contract wordings;
- Collateral agreement wordings;
- Trust account contracts;
- Letters of Credit;
- Internal audit reports;
- A syndicate’s Minimum Standards Self-Assessment (SA) and associated internal reports and findings; and
- Copies of correspondence with the PRA and other regulators.

Appendix – Links

Performance Management Supplemental Requirements and Guidance –
https://www.lloyds.com/market-resources/requirements-and-standards/supplemental-requirements-and-guidance