LLOYD'S

Lloyd's Minimum Standards MS2 – Underwriting and Controls

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MS2: Underwriting and Controls

Minimum Standards and Requirements

These are statements of business conduct required by Lloyd's. The Minimum Standards are established under relevant Lloyd's Byelaws relating to business conduct. All Managing Agents are required to meet the Minimum Standards. The Requirements represent the minimum level of performance required of any organisation within the Lloyd's market to meet the Minimum Standards.

Within this document the standards and supporting requirements (the "must dos" to meet the standard) are set out in the blue box at the beginning of each section. The remainder of each section consists of guidance which explains the standards and requirements in more detail and gives examples of approaches that Managing Agents may adopt to meet them.

Guidance

This guidance provides a more detailed explanation of the general level of performance expected. They are a starting point against which each Managing Agent can compare its current practices to assist in understanding relative levels of performance. This guidance is intended to provide reassurance to Managing Agents as to approaches which would certainly meet the Minimum Standards and comply with the Requirements. However, it is appreciated that there are other options which could deliver performance at or above the minimum level and it is fully acceptable for Managing Agents to adopt alternative procedures as long as they can demonstrate that they meet the Minimum Standards.

Definitions

Binding Authority: An agreement between a Managing Agent and a Coverholder under which the Managing Agent delegates its authority to enter into a contract(s) of insurance (to be underwritten by the members of a syndicate managed by it) to the Coverholder in accordance with the terms of the agreement.

Consortium: A contractual arrangement under which one or more Managing Agents delegate(s) authority to another Lloyd's Managing Agent to enter into contracts of insurance on their behalf. A consortium will underwrite and bind specific classes of business produced from more than one Lloyd's broker (which is the main difference to a Line Slip). This form of delegation is permitted in accordance with paragraph 1 (c) of the Intermediaries Byelaw.

Coverholder: A company or partnership authorised by a Managing Agent to enter into a contract(s) of insurance (to be underwritten by the members of a syndicate managed by it) in accordance with the terms of a Binding Authority.

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

KPIs: Key Performance Indicators

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.

Line Slip (includes broker covers, facilities and programmes): An agreement by which a Managing Agent delegates its authority to enter into contracts of insurance to be underwritten by the members of a syndicate managed by it to another Managing Agent or authorised insurance company in respect of business introduced by a Lloyd's broker named in the agreement.

LITA: Lloyd's Internal Trading Advice

PBQA: pre-bind quality assurance

SBF: Syndicate Business Forecast

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

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

MS2: Underwriting and Controls

UWC 1.1 Underwriting & Controls Framework

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

Managing Agents shall ensure that:

- there is a nominated director responsible for underwriting systems and controls;
- for each managed syndicate there is a written Underwriting Policy and/or Underwriting Procedures which is reviewed annually;
- underwriting practice is aligned to the strategy, approved Business Plan and Underwriting Policy/Procedures and takes account of pricing levels, updated aggregate exposures and reinsurance arrangements;
- underwriters have the appropriate experience and capabilities to write and manage policies profitably in line the approved Business Plan, and to provide a good service to customers across the lifecycle;
- underwriters' terms of reference / authorities are in writing, properly authorised, signed and reviewed annually, and are aligned to the Syndicate Business Plan;
- risks that are outside of an underwriter's agreed level of authority are referred to an appropriate individual;
- there are requirements for Leaders to undertake pre-bind contract reviews (including checks on contract certainty, regulatory and Lloyd's advisory rules) on all risks that they lead;
- there are appropriate procedures and resources for review and agreement of contract wordings;
- there is regular review of the expertise and quality of advice given by external experts (e.g. technical engineers, surveyors) used to inform underwriting decisions; and
- underwriting addresses external regulatory requirements.

Effective systems and control

Effective systems and risk-based controls are essential for the delivery of the Managing Agent's strategy and Syndicate Business Plan. To facilitate this, it is expected that the Managing Agent's Board will nominate one director such as the Chief Underwriting Officer, Active Underwriter or Head of Underwriting Management or similar, to be responsible for the Managing Agent's underwriting systems and controls across different classes and distribution channels. The Managing Agent shall ensure that the nominated director and supporting staff have the requisite skills, experience and time available to manage and execute the controls effectively.

Reference to 'effective systems and controls' should be interpreted as widely as necessary for the effective management of each syndicate. Controls are seen broadly to sit under two headings:

- Prevention controls - These include, for example, written authorisation and proactive management of each underwriter’s authority and of any variances to prescribed procedures/authorities; and
- Detection controls - These include, for example, internal audit reviews, peer review processes and independent reviews.

Underwriting Policy and Underwriting Procedures

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

The Underwriting Policy would usually include an overarching underwriting strategy and generic controls that apply across all lines of business and distribution channels and types of placement, whilst the Underwriting Procedures would usually include more specific guidelines, processes and controls to implement the policy at class of business level. These documents, which may set out different procedures for when the MA is leading or following, will typically cover the following elements for each syndicate:

- Reporting lines and Committee framework;
- Underwriting authorities and line guide details by class of business;
- A process for authorising material deviations from the Business Plan or line guide requirements;
- Systems and controls in place for managing any conflicts of interest relating to any current or proposed underwriting transaction;
- Peer and independent review procedures;
- Delegated authority procedures;
- Compliance with regulations including sanctions, financial crime, conduct, etc
- Approach to fronting business for other insurers;
- Approach to multi-year policies;
- Approach to ensuring that Contract Certainty and Pre-Bind Quality Assurance is achieved;
- A clear expectation of pricing levels and an audit trail to show how pricing will deliver the projected results within the approved Business Plan and how pricing will be managed over the relevant underwriting cycle;
- Line sizes and aggregates are managed within the parameters of the approved Business Plan;
- Appropriate reinsurance coverage is in place;
- Governance and control procedures relating to algorithm model risk appetite and underwriting.

Managing Agents are also expected to ensure that underwriting takes into account Lloyd's 'Performance Management – Supplemental Requirements and Guidance'. These can be found by clicking on the link: http://www.lloyds.com/supplementalrequirements

Multi-Platform Underwriting Protocols

Where a Managing Agent manages more than one syndicate and/or is part of a group consisting both of a syndicate under the management of the Managing Agent and group (re)insurance company(ies), then the Managing Agent should have a documented policy for the allocation of business between syndicates managed by it and/or between the syndicate(s) managed by it and any group (re)insurance companies. The policy should set out objective and clear criteria for the allocation of business and be reflected in Underwriting Authorities.

Managing Agents should, where possible, avoid having criteria that allow for a material level of discretion in the allocation of business. Lloyd's would expect the criteria to be outlined by class of business and take into account a variety of factors including licencing, line size and client choice. The policy should also address conflict of interest at the [entity/firm] level and at the level of individual underwriters who may have authority to underwrite for more than one syndicate and/or a syndicate and one or more group companies. (Note that where an individual underwriter is authorised to underwrite for two or more syndicates then approval from Lloyd's will be required pursuant to the Multiple Syndicate Byelaw.)

Underwriting Capabilities

- Leaders are expected to be experts in the areas that they write, offering value to the Syndicate and confidence to Followers.
- Managing Agents are expected to have the capability to monitor individual contract performance to flag up any potential issues or opportunities as soon as possible.
- Leaders are expected to be the main point of contact for the broker/assured and so must have the resources in place to support customer needs on an ongoing basis. Further requirements and guidance on this may be found in MS9.
- Where appropriate, Followers should look to take advantage of work undertaken by the lead and seek to reduce unnecessary duplication of effort.

- Individual Underwriters authority should be set in line with requirement UWC 1.1. There should be a process in place to monitor underwriter capabilities and performance and a link to their underwriting authority.
- Followers may not need to be experts in the individual areas written but should still have sufficient experience and skill to select risks and monitor performance against the approved Business Plan with a strong emphasis on portfolio management. This capability could be in the form of technology-based underwriting approaches e.g. algorithms.
- Advice provided by external experts should be monitored over time against actual experience and should take into account the detail of the advice given and the quality of the supporting evidence.

The Underwriters' Terms of Reference and Authorities

It is expected that, when issuing each underwriter's terms of reference and authority, it should be written, properly authorised and reviewed annually to reflect their experience, knowledge and appropriate expertise (e.g. to risk select/price/agree a wording), and to ensure alignment with the approved Business Plan. Each underwriter should signify agreement by signing their authority details and it should be counter-signed by the Active Underwriter or as delegated to a senior underwriter, such as a Class Underwriter. The Active Underwriter's authority should be counter-signed by a member of the Board. Electronic signatures and counter-signatures are acceptable.

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

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

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

Pre-Bind Contract Review

Managing Agents should maintain effective Pre-Bind Quality Assurance (PBQA) procedures with clear accountability for their operation and a review process to ensure that they remain appropriate to the Managing Agent's specific business requirements.

Leaders are expected to conduct a pre-bind contract review on all contracts (risks or portfolios). This is important to ensure contract certainty for all customers, ensure that coverage meets regulatory requirements and reduce the cost of unnecessary policy reissue later in the process.

While Leaders are required to conduct checks on all contracts, the extent of reviews can be risk-based. This could range from the Leader reviewing every contract individually for large complex open market business, to an approach for homogenous binder business where the Leader would check standard policy forms and schedule templates before writing or renewing the binder, but delegate the activity of ensuring schedules are completed accurately to the Coverholder. The Leader could assess this through audits of policies issued, KPIs, complaints monitoring, signing off Coverholder policy issue controls.

Managing Agents may wish to take the following factors into account when determining which level of review is appropriate:

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

In the spirit of avoiding unnecessary duplication and cost in the market, Leaders are encouraged to indicate on the slip that the PBQA check has been completed to their satisfaction or to confirm this to brokers and to give them permission for this confirmation to be shared with Followers.

Lloyd's has removed from the Minimum Standards the requirement for Followers to conduct pre-bind checks and expects each Managing Agent to decide which controls they wish to apply to ensure the quality of wordings for their Follow business. This may for example result in a shift to post bind contract review, a list of preferred leaders or a set of criteria determining cases when a pre-bind review should still take place. When conducting PBQA Minimum Standards reviews, Lloyd's will only include Lead business in the scope.

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

KPIs should be maintained on the extent of PBQA undertaken and there should be regular reporting to relevant committees within the Managing Agent and feedback to underwriters on contract quality and contract certainty of slips and wordings taking into account items such as:

- Identification of claims issues arising from wordings e.g. coverage disputes;
- Identification of issues arising from lack of experience;
- Output from internal audit process;
- Customer complaints;
- Independent review of the quality of a sample of wordings on a risk-based approach;
- Any issues regarding reinsurance slip conditions or underlying/associated wording; and
- Feedback from Lloyd's review process.

Market Reform Contract (MRC)

The Board has mandated through the Underwriting Requirements (paragraph 3A) that Managing Agents shall not permit the Syndicate stamp of a syndicate managed by it to be affixed to any slip which relates to a contract or contracts of insurance unless:

a) the slip is in the form of the Market Reform Contract and the information contained in the slip has been properly completed in accordance with the relevant London Market Group guidance;
b) the slip has been marked "MR Exempt – Client Requirement"; or
c) the slip relates to motor business, personal lines business or term life insurance business and the slip will not be processed by Xchanging Insurance Services.

MRC Guide Version 1.5 - Line slips are required to be in the format and completed in accordance with the guidance issued by the London Market Group. The current version of the came into effect on 1 June 2018 and the use of the line slip template for which it provides ("MRC Template") has been compulsory in the Lloyd's market since that date.

[**Link to MRC Guide Version 1.5** – https://lmg.london/document-library

Available tools/ information

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

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

  [Link to London Market Group Website] – https://lmg.london/

- The Lloyd's Wordings Repository (of model clauses & wordings) – a readily available source of model wordings and a home for Managing Agents who want to retain their own wordings safely and securely, with international access via lloyds.com. This can be found at the following link:

  [Link to the Lloyd's Wordings Repository] – https://www.lloydswordings.com/

- Lloyd's QA Tools – provides a checklist of regulatory, tax and Lloyd's advisory rules against which slips can be reviewed. This can be found at the following link:

  [Link to Lloyd's QA tools] – https://www.lloyds.com/tools-and-systems/quality-assurance-qa-tools

- **Lloyd's Contract Confidence –** enables automated contract checking against the rules in the Lloyd's QA tool, with a system generated output of potential issues for underwriters to review**. Functionality** also includes document comparison, a check against Managing Agent preferred clauses, and the ability to create customised rules to flag documents/wordings that conflict with your own risk appetites or underwriting strategies.

  [Link to Lloyd's Contract Confidence] – https://www.lloyds.com/tools-and-systems/contract_confidence

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

  [Link to Crystal] – https://www.lloyds.com/tools-and-systems/crystal

- **Risk Locator** tool provides guidance on what to consider when identifying the locations of risk for regulatory and tax purposes.

  [Link to Risk Locator] – https://www.lloyds.com/tools-and-systems/risk-locator

- **Market Bulletin 5213** advises the market about Crystal content and regulatory guidance tools that have been developed for use when writing business on behalf of Lloyd's Brussels. This includes a link to the Brussels Stamp decision tool**.**

- **LMA 3145 Model Consortium Agreement -** The template LMA Consortium Agreement and guidance documents were published on 16 June 2017. These documents were produced with input from market experts and legal input provided by Clyde & Co LLP, and the market model and guidance were endorsed by LIIBA on behalf of its members. Its use is not mandatory but it provides useful guidance when determining appropriate clauses to reflect the commercial terms of each contract.

  [link to LMA Model Consortium Agreement]:
  https://www.lmalloyds.com/LMA/News/LMA_bulletins/xLMA_bulletins/LMA17_026_AC.aspx

Contract certainty in the placement of business in overseas territories

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

Lloyd's recognises that London placement practices are not always easily transferable to overseas territories. Where existing Lloyd's tools/guidance can be used to good effect Lloyd's recommends that as good practice. Where

Managing Agents operate alternative approaches, which can be demonstrated to be effective, Lloyd's has no concerns.

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

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

External Regulatory Requirements

Managing Agents are expected to have controls in place to ensure that regulatory requirements and the scope of Lloyd's market licences are clearly understood and that risks are written within those requirements.

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

[see above links to Crystal, Risk Locator and the QA Tools]

Potential Evidence

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

UWC 1.2 Underwriting & Controls for Delegated Authority Business

Where underwriting authority is delegated to a third party (e.g. Coverholders, or to leaders of Lineslips and Consortia), Managing Agents shall ensure that business written on their behalf and/or on behalf of others is profitable and proactively managed and controlled in line with their Underwriting Policy and Procedures.

Managing Agents shall ensure that:

- they have the capabilities necessary to assess the terms of the delegated authority contract and the prospects of the business that will be underwritten on their behalf to ensure alignment with their Risk Appetite and approved Business Plan;
- any authority granted to a third party regarding pricing, coverage and risk selection is fully aligned to the Syndicate's own underwriting philosophy regarding capabilities and experience;
- when leading, they maintain an open and proactive engagement with the Coverholder/broker to ensure performance issues are addressed quickly and underwriting philosophies remain aligned;
- risk and exposure information is sufficiently detailed, allowing for robust segmental performance monitoring, analysis and challenge; and
- there is complete transparency and timely disclosure of any known potential conflicts of interest between leaders and followers at the commencement of the delegated authority contract.

This standard applies to all business written where there is delegation to a third party. In addition to above standard, all Managing Agents writing delegated authority business are required to follow the standards relating to delegated authority set out in MS3 (Price and Rate Monitoring) and MS9 (Customer).

Although each syndicate should satisfy itself that the third party is meeting Lloyd's standards, Leaders of delegated binding authority business, in particular, are expected to demonstrate that they are proactively engaged with the Coverholder/broker to ensure performance issues are addressed quickly and underwriting philosophies remain aligned.

Delegated Authority Contracts

- Delegated authority contracts must include requirements for the third party to provide the participants with relevant, timely and sufficiently granular information, allowing for robust segmental performance analysis and challenge of business written (e.g. by premium, claims, exposures, risk-adjusted rate change etc.).
- The level of commission, including profit commission, should reflect the level of services provided and the level of performance.
- Potential conflicts of interests between Leaders and Followers should be disclosed expediently, particularly when Leaders have authority to act on behalf of Followers with full binding authority.
- Each contract must have a defined referral process for any specific risk where an exposure may breach delegated authority rules.

Binding Authorities

- Managing Agents should regularly monitor and review the performance of the binder against expectations, and to ensure it remains in line with Business Plan and Risk Appetite.
- Leaders should conduct regular reviews of Coverholder underwriting guidelines, wordings, models and controls to ensure they remain fit for purpose.
- Any issues identified should be raised immediately with the Coverholder in order to facilitate appropriate and timely remediation.

Line Slips and Consortia

- It is expected that there will be a contractual relationship between Leaders and Followers. This should include responsibilities for sharing relevant, timely and sufficiently granular underwriting and claims information to ensure all participants can meet this Minimum Standard.
- Whilst the Followers are expected to have the level of expertise necessary to assess the (expected) performance of the arrangement and monitor how it aligns to the Syndicate Business Plan, this may not require a dedicated class underwriter.

UWC 1.3 Underwriting & Controls Audit and Review

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

Managing Agents shall ensure that:

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

Retention of all relevant information
Each Managing Agent is expected to be able to produce all relevant information regarding each risk written to satisfy audit purposes and to allow the proactive review and management. Relevant information would include slips and placing information (incl. risk assessment surveys etc), as well as the rationale for risk acceptance, terms and pricing.

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

Testing of underwriting controls

Managing Agents are expected to test and record the effectiveness of underwriting controls on at least a quarterly basis, with any variances or control failures highlighted and addressed. The findings from control testing should be shared with relevant underwriting teams and actions relating to variances agreed and monitored. Key findings should be reported to the Board as appropriate. Testing should ideally include consideration of referrals and breaches of underwriting authority, reinsurance programmes, systems for modelling risks and aggregating exposures and the records supporting pricing.

Peer and Independent Review

A Peer Review or Underwriting File Review process should be in place to ensure compliance to Underwriting Policy and adherence to Underwriter Authorities.

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

All material delegated authority contracts should be reviewed and assessed regularly by an appropriately qualified Independent Reviewer.

The guidance for Independent Review referred to here is:
https://www.lloyds.com/market-resources/underwriting/independent-reviewers/useful-information

Potential Evidence

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