Browne Jacobson

Lloyd's new rules for delegated authority business – a change for the better?

Lloyd's has announced changes to its rules on delegated authority (DA) business, aiming to embrace technology and a more risk-based approach.

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In a 'market bulletin' from July 2019 titled 'A New Approach to Third Party Oversight – Byelaw Changes' (Y5257) Lloyd's has announced changes to its rules on delegated authority business, aiming to embrace technology and a more risk-based approach. The move is part of the wider 'Future at Lloyd's' programme, which some regard as essential to Lloyd's' continued existence.

The changes to delegated authority business follow consultation with the market earlier this year. The challenges Lloyd's sought to address may not surprise many delegated authority practitioners:

1. The length of time for coverholders to be authorised (over 200 days in some instances)
2. Missed opportunities for business that does fit into Lloyd's current rules
3. Inconsistent and multiple requests for due diligence information;
4. Manual processes and lack of data use, leading to errors and time inefficiencies.

The proposed changes received wide support from 77 respondents (e.g. coverholders, managing agents, brokers and third party administrators).

This support is especially unsurprising given longstanding concerns about operating costs at Lloyd's, as noted by, for instance, the 'London Matters 2017' report from the 'London Market Group' (which includes representatives of Lloyd's and its managing agents) and 2019 media reports on credit rating analysis of Lloyd's - which referred to expense ratios and (because of the levels of attritional and other claims) the decreasing contribution of loss reserves to profitability. The latter in particular means that the market needs to improve underwriting operation profitability.

Lloyd's changes are set to be implemented in early 2020.

Fit for purpose …

Lloyd's has recognised that its current rulebook has not kept pace with new distribution methods; the rules don't adequately deal with online offerings or conduct risks. Lloyd's is especially keen to ensure that delegated authority business is adequately addressed as it is the source of 32% of the market's premium income. It is also the fastest growing source, as stated by Paul Brady, Head of Delegated Underwriting at Lloyd's, in a talk for the British Insurance Law Association ('BILA') in June 2019.

Rule changes will be achieved primarily through amendments to the Intermediaries Byelaw, to allow a more sophisticated approach.

1. More straightforward applications will be responded to based on the risk of the proposed business and the capabilities of the Managing Agent. In his recent talk, Paul Brady explained that Lloyd's expects up to one third of applications will be on a lower risk

basis, and that these will be dealt with automatically. A further 30% will be looked at by the Lloyd's approvals team, but in a more focussed way. These efficiencies will free up time for Lloyd's to review more complex risk in a more timely manner.

2. There will be a new category of delegated authority business where prior Lloyd's approval will not be required: 'Distributors' who sell insurance with no discretion on the terms or rates, and who are not insurance 'experts' (as termed by Paul Brady in his BILA talk), such as 'point of sale' insurance (e.g. with concert tickets). Distributors will not be able to use the Lloyd's brand, and Managing Agents will be held account to ensure it does appropriate due diligence on that business. Distributors will not be able to deal with claims or complaints and will initially be UK domiciled-only.

3. The prohibition on sub-delegation will be removed to allow new kinds of delegated authority transaction. For example, Managing Agents will be able to use online portal service providers to distribute insurance if terms are set out and the product cannot be amended. All sub-delegation will be treated as high risk initially.

4. Claims Third Party Administrators (TPAs) will be brought within Lloyd's compliance and oversight. These parties will be termed Delegated Claims Administrators (DCAs). The purpose behind bringing TPAs within Lloyd's oversight is to ensure consistency and ultimately reduce duplication of process. Existing DCAs will be 'grandfathered' in to the new process, but ultimately the approval and oversight of DCAs will mirror that of coverholder approval.

New tech

Underpinning such changes will be the rollout of a new tech platform – Chorus – to support the delegated authority process. This will replace current systems ATLAS and BAR, and is intended to be much more dynamic, enabling a tailored due diligence process depending on the type of coverholder and requirements under the amended Byelaw. Managing Agents will also be able to add their own questions to Chorus, to make it a 'one stop shop' and therefore reduce time and cost. As the administrative cost of doing business at Lloyd's is currently 40% of premium income, compared to 30% in other markets (as stated in the 'Future of Lloyd's Prospectus Launch' speech of John Neal, Lloyd's CEO) such reductions are vital.

Commentary

Lloyd's recognises both in these proposals and the wider Future at Lloyd's programme that the market has not reacted quickly enough to the changing risk landscape and the sustained 'soft market'. Many large businesses comprise largely intangible assets (think of Netflix, Uber, Airbnb, Facebook) and businesses are now more vulnerable to emerging risks such as cyber. The continued stream of alternative sources of capital into the insurance and reinsurance markets means that pressure continues to build on insurance providers to differentiate themselves from competitors, attract and retain commercially valuable customer bases (whose claims are sufficiently lower in value than the premiums they pay) and maintain profitability. There is also a real opportunity to harness various international and local risks that are not currently insured, by using modern distribution methods and technology to reach and engage new customers as well as assist in accurate pricing.

Of course, commercial realities are one thing, but regulatory considerations are something else. It is arguable that in being seen to 'loosen the shackles' on distribution and delegation now, Lloyd's risks sowing the seeds for future adverse reaction from the Financial Conduct Authority ('FCA'). The FCA has long been concerned about the effectiveness of general insurance firms' (which would include Managing Agents') methodologies to ensure customer fair treatment in relation to the delegation of marketing, underwriting and claims handling (see eg the 'General insurance distribution chain' thematic review TR 19/2 from April 2019, which in turn referred to prior reviews from 2015 and 2016).

Lloyd's' consultation for the rule changes explicitly acknowledged the FCA's earlier work, stating that *"Managing agents will … be expected to have robust arrangements in place for carrying out due diligence on distributors before appointing them, complemented by ongoing and appropriate monitoring of the distributor".* However, the FCA's concerns are wider and deeper than this. In particular, the FCA expects firms to have a constant, immediate and comprehensive ability to know how a delegate or sub-delegate is dealing with customers, and that products represent value for money. Managing agents risk severe adverse reaction from the FCA if they simply seek re-confirmation of their findings from initial due diligence. It may be 14 years since a Managing Agent (GosHawk) was fined by the regulator for delegated authority failings, but the risks of this happening again now are arguably greater.

John Neal described the change in approach to distribution as a 'once in a generation opportunity'. One way or another, he might not be wrong.

Contact

Mark Hickson

Head of Business Development

onlineteaminbox@brownejacobson.com

+44 (0)370 270 6000

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