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# Lloyd's Conduct Risk Minimum Standards

## An important step towards an industry response to conduct risk


### Introduction

- Lloyd's has released its new Conduct Risk Minimum Standards (the "Standards") with compliance required of all Managing Agents by the beginning of 2015. The Standards are the first documented rules and guidance on how Managing Agents must identify, assess, mitigate and oversee conduct risk.

- A four week consultation period for the Standards started on 20 June 2014 with the final version expected in July 2014.

- The Standards are an important step for Lloyd's and London Market conduct regulation and supervision. With unprecedented focus on this market by the Financial Conduct Authority (FCA), it is important for firms to find a risk-based and proportionate solution to conduct risk. Firms are at varying stages of achieving this but in the absence of regulatory rules or guidance, the complexities and inconsistencies of the market have made this challenging.

- It has been clear that a market solution is necessary. The Standards aim to assist Managing Agents to meet FCA expectations and increase consistency across the market.

### Headlines and key challenges

- The Standards consist of 19 sections set out over 37 pages and broadly describe what a high-level conduct risk framework looks like.

- The Standards apply to all Managing Agents and all lines of business – from personal lines, to commercial lines including large risks and reinsurance; and from homogenous to bespoke products.

- The Standards directly apply to any business with Lloyd's customers who are domiciled or registered within the European Economic Area (EEA). Outside the EEA, the majority of the Standards need only to be considered in light of local conduct requirements and good business practice. The Standards do not refer to "wholesale" or "retail" business which avoids confusion over the different ways these terms can be interpreted.

- The Standards are not (and nor could they be) a "one-stop shop" for firms to design, implement and embed a risk-based, proportionate and practical conduct risk framework. Firms will need to interpret and apply the Standards to come up with solutions that work for them. This brings challenges to overcome.

- Overleaf, we set out examples of the headline requirements from the Standards and the associated key challenges in achieving compliance.

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**Figure 1. Headline requirements from the Standards and the associated key challenges in achieving compliance**

| Section | Headline | Key challenges |
|---|---|---|
| **CR4 and CR5** | **Product Risk assessments** | **What is a product? What conduct risks should be assessed?** |
| The Standards centre on Product Risk assessments. Managing Agents are required to assess the different level of inherent conduct risk from their different products, supply chains and end-customer financial sophistication. This provides the foundation for a risk-based and proportionate conduct risk framework, as Managing Agents are directed towards focusing their time and resource towards products that pose greater inherent conduct risk. | | A Managing Agent can have 5 or 5000 products depending on how a "product" is defined. One of the first challenges is to find a suitable way to segment the products at the right level of detail to assess the varying levels of conduct risk, while keeping it practical and not onerous.<br><br>The Standards suggest examples of risk factors to include in the Product Risk assessment. As conduct risk is a broad topic, Managing Agents should augment, tailor and calibrate their risk factors to bring out the different conduct risk profiles across their products. For example, it is critical that Product Risk assessments provide a proportionate solution to different geographic locations. |
| **CR2, 6-12, 14** | **Product lifecycle governance** | **Innovative and practical solutions** |
| The Standards require Managing Agents to have customer-centric processes, controls and governance at Product Design, Product Sales and Product Service – key stages of the product lifecycle. This includes reviewing and acting on information on the product's conduct risk performance. The Standards confirm that firms should focus these processes proportionately towards higher risk products, as identified by the Product Risk assessment. | | Regulatory expectations around product lifecycle governance are not new but Managing Agents will need to find innovative solutions to make them work in the Lloyd's market. For example, what is the best way to show conduct risk has been mitigated in the design of open market products where an underwriter is being asked to stamp the slip in the box? How should compliance, risk and internal audit provide integrated assurance over product lifecycle governance? What conflicts of interest should Managing Agents identify and mitigate across the product lifecycle?<br><br>Overall, we suggest Managing Agents start by adding a conduct lens to existing controls and oversight to enhance efficiency and embedding, before complimenting these with additional processes where necessary. |
| **CR15 and 16** | **Coverholder and TPAs** | **How to find a risk-based and proportionate solution for agency control and oversight?** |
| The Standards require Managing Agents to identify and mitigate conduct risk during the take-on and on-going oversight of their Coverholders, Service Companies and Third Party Administrators (TPA). The Standards confirm that this control and oversight should be focussed proportionately towards higher risk products and/or agents. | | To find a risk-based and proportionate solution to agency control and oversight, Managing Agents need to understand the different conduct risk profiles across their Coverholder and TPA populations. The Product Risk assessment methodology can be adapted to assess more specific conduct risks relating to these agency relationships. The output needs to transparently show the agents with higher conduct risk profiles so that Managing Agents can focus time and resource towards these. For example, a conduct risk assessment of the Coverholder population should take into account the different level of conduct risk posed by the existence of sub-delegation. |
| **CR8** | **Assurance from others** | **What is the most efficient way to obtain assurance?** |
| The Standards include provisions for Managing Agents to place reliance on market counterparties by obtaining assurance over their conduct risk controls and processes. For example, following underwriters can obtain assurance over the lead underwriter's product design. | | The recognition that Managing Agents can place reliance on market counterparties is important. It seeks to minimise cost in the market by removing duplication and increasing efficiency. However, as it is clear that this should not be "blind reliance", Managing Agents must obtain assurance over any reliance placed. What is the most efficient way for following Managing Agents to obtain assurance over the lead? What type and extent of documentation relating to product design should be requested and reviewed by following markets? |
| **CR2, 3, 13** | **Conduct governance and MI** | **What does good conduct MI look like? Are there systems limitations?** |
| The Standards require Managing Agents to have a Product Oversight Group or to ensure existing Committees have the capability and capacity to undertake this conduct risk role. The Standards also require Managing Agents to update the sophistication of their conduct Management Information (MI) with examples provided on conduct risk metrics. | | There has been a step-change in the type, breadth and depth of conduct risk metrics that Managing Agents are required to include in their conduct MI. The risks identified through Product Risk assessments should be taken into account when deciding on conduct metrics. This MI should then be escalated in a risk-based way through clear governance structures.<br><br>However, how will Managing Agents overcome systems limitations that may impact aspects of MI collection and review? For example, the availability of certain data from Coverholders. |

## Next steps

- Compliance with the Standards can be achieved by the beginning of 2015. However, this will require Managing Agents to take steps without delay.

- We suggest that other Lloyd's and London Market firms may also want to consider taking steps in line with the Standards, as regulatory scrutiny of London Market insurers and brokers may also take into account (at least indirectly) these new conduct risk rules and guidance for Managing Agents.

- Examples of what firms can do now include:

  – **Gap analysis and project plan:** There is a lot to do in a short space of time. This is likely to present resourcing and capacity constraints that require careful planning and structure to overcome. Firms should start by understanding how their current conduct risk framework compares to the Standards to give an idea of the resource required to achieve compliance by the deadline. A structured project plan with stakeholder governance and challenge should add robustness to the process.

  – **Stakeholder engagement:** The Standards require Board and Senior Executive input and approval. For an effective conduct risk framework, firms will also need to engage with a cross-section of stakeholders including underwriters and control functions. Firms should ensure early engagement to update and provide information, clarify roles, manage expectations and gain vital input.

  – **Documentation and audit trails:** The Standards acknowledge the regulatory approach that "if it isn't written down, it didn't happen" and accordingly require firms to maintain documented methodologies, audit trails and outputs. Firms should start documenting their methodology, materials and template outputs for their Product Risk assessments to ensure clear, consistent and robust approaches.

  – **Counterparty engagement:** Addressing conduct risk in wholesale insurance markets requires supply chains to work more closely together. Firms should start communicating with counterparties (for example, lead or follow markets, Coverholders and/or brokers) to ensure input and buy-in to changes. Firms may also want to explore how best to place reliance on each other to avoid duplication of processes and increase efficiency.

- It is important for the Lloyd's market that Managing Agents achieve a consistent quality of conduct risk frameworks. Lloyd's will therefore be undertaking assurance work over its Managing Agents to assess compliance with the Standards during 2015.

- Deloitte is working with a number of Managing Agents to help with their conduct risk assessments, and conduct risk control and oversight frameworks in light of FCA expectation and the Standards. This involves overcoming the challenges highlighted.

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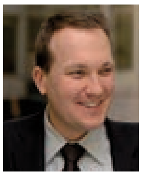
## Contacts



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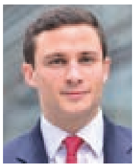

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