Contract Certainty
Industry Assessment of Success

Contract Certainty Steering Committee submission

8 January 2007

Statement from the Contract Certainty Steering Committee

- We believe the UK insurance industry has made very substantial progress in its efforts to reduce the operational, legal and reputational risks of uncertain contracts.
- This progress is fundamental, demonstrable and enduring.
- This Industry Assessment of Success document summarises the basis upon which we have reached this conclusion. It acknowledges the critical role played by the FSA as a catalyst for action and sets out the further work we intend to do to ensure that contract certainty becomes fully embedded in the day-to-day conduct of the market.
- Contract certainty is only one element in a wider programme of market reform that will benefit firms, clients and investors alike.

Contract Certainty Steering Committee

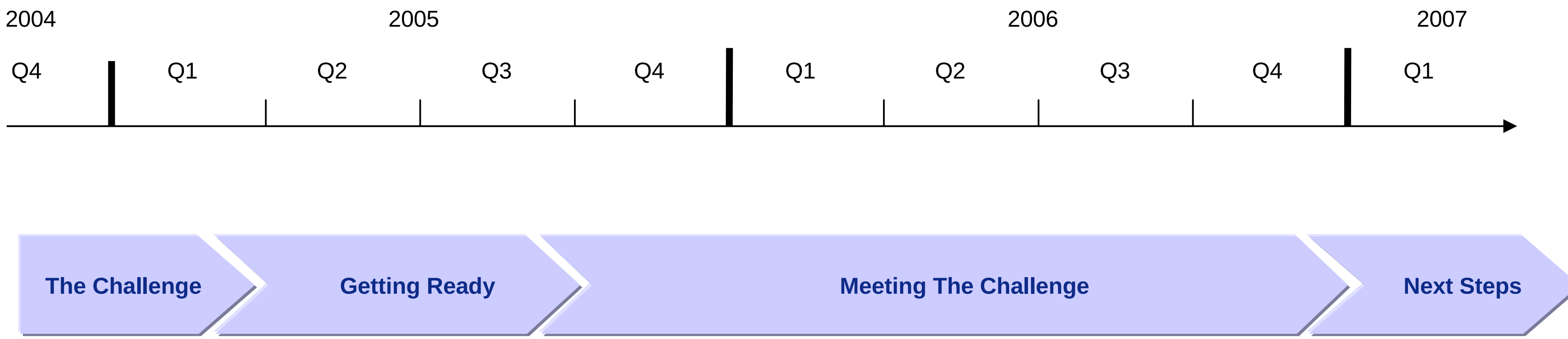
2004		2005				2006				2007
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1

The Challenge
- Background
- The FSA Challenge

Getting Ready
- Mobilising the Market
- Issues that the Market Faced
- Success Criteria

Meeting The Challenge
- Delivering Operational and Process Benefit
- Meeting the Targets
- Addressing Exceptions
- Addressing Legacy Contracts
- The Voice of the Customer
- CCSC Assessment

Next Steps
- 2007 Contract Certainty Objectives
- The Ongoing Change Agenda
- Delivering an Industry Solution



Background

The FSA Challenge

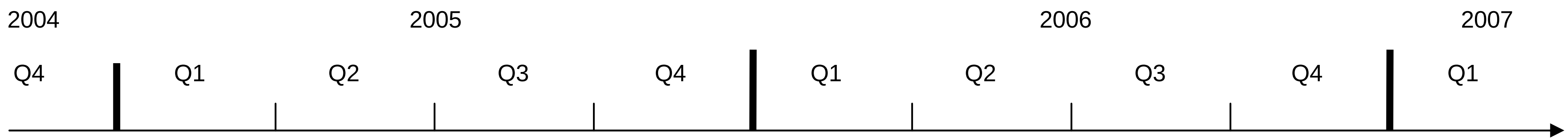
The insurance industry was aware of the risks that it had historically run through a lack of attention to the detail of the insurance contract

- **How did this issue arise?**
  - Global, historic practice and culture, a legacy of the past. Not just an issue for the UK.
  - Ever-increasing demand for complex coverage.
  - A focus on the deal rather than on the detail of the contract.
- **There was a need to maintain the efficiency and reinforce the competitiveness of the UK Insurance Industry and the pre-eminence of London as the market for complex commercial risks. The industry was already:**
  - Introducing the LMP slip for the subscription market to raise the standard of submissions.
  - Carrying out post-inception contract checking within the subscription market.
  - Addressing the need for contract certainty. The goal of contract certainty at inception had been defined. Momentum was building but an increase in pace was needed.

The FSA provided the catalyst for the industry to progress further and more quickly.

In December 2004, John Tiner set out the requirement to end the "deal now, detail later" culture

- **John Tiner set the challenge in his speech of December 2004:**
  - Greater certainty at inception of the contract, with full policy documentation promptly thereafter. The FSA want to see the end of a practice that is "deal now, detail later".
    - The insurer has an incomplete knowledge of the risk it has underwritten.
    - For brokers there are large and unquantifiable legal risks.
    - Delays create treacle in the back office and ever longer, more arduous, reconciliations.
    - The insureds do not know exactly what protection they have bought.
  - Square the circle of a richly diverse market, which is able to price and absorb complex risks with one which is efficient, orderly and fair.
  - The market to organise itself to take this forward and to come up with a work plan which will see delivery of solutions within two years.



The Challenge | Getting Ready | Meeting The Challenge | Next Steps

Background

The FSA Challenge

Mobilising the Market

Issues that the Market Faced

Success Criteria

The industry needed to be mobilised to respond to the challenge

How did the industry respond?

- **Governance, communication channels and working groups**
  - Governance established in Q1 2005. Project Boards set up in each market sector and industry-wide representation by the Contract Certainty Steering Committee.
  - Existing Market Associations partnership (Market Reform Group) and Non-Subscription Practitioners Group established to contribute subject matter and facilitate firms' achievement of the objectives.
  - Subscription/Non-Subscription liaison and AIRMIC liaison established through Contract Certainty Steering Group.

- **Large-scale market communications initiative**
  - CEO letter series providing updates and guidance for the market.
  - Multiple briefing sessions, workshops and question & answer sessions from 4th Quarter 2005 to 4th Quarter 2006.
  - Market surveys covering both Subscription and Non-Subscription Markets.

The industry faced a number of challenges that needed to be addressed to implement the market solution to contract certainty

- **The need to establish clarity on an industry-wide basis:**
  - Definition of contract certainty.
  - Guidance on how to achieve contract certainty.
  - Criteria against which to measure contract certainty.
  - Measurement regime for contract certainty.
- **The need to change culture and behaviour:**
  - Recognition and acceptance of the challenge.
  - Realisation of the impact of change.
- **As a priority, focus on delivering contract certainty to prevent the creation of a new legacy issue:**
  - Then address the legacy issue once the situation has improved.
- **The need to be able to verify that the market was making progress:**
  - Demonstrate tangible success.
  - Identify areas for attention.

The industry established a set of success criteria based on what it needed to achieve and a measurement regime to assess its progress

Key success criteria:	Assessed by:	
Improvement in processes and operational management capability	Contract certainty principles embedded in firms operational procedures, as measured by the surveys	
Percentage of contracts meeting contract certainty criteria	Subscription market • 30% certain by December 2005 • 60% certain by June 2006 • 75% certain by September 2006 • 85% certain by December 2006	Non-Subscription Market • 100% certain by 31 December 2006
Extent of senior management engagement	Percentage of management boards certifying adoption of Contract Certainty Code of Practice	
Affirmation by FSA of market view of progress	Feedback from the FSA on firms' performance	
Extent to which firms understand exceptions	Survey results	
Reduction in number of Legacy contracts	Number of Legacy contracts remaining in each priority category	
Ability to demonstrate that firms have embedded an effective measurement framework	Survey results	
Ability to demonstrate the development of a capability to sustain change	The successful delivery of further reform within the London Market	
Making an industry solution to contract certainty work	The decision by the FSA not to introduce further rules-based regulation	

2004 Q4 | 2005 Q1 | Q2 | Q3 | Q4 | 2006 Q1 | Q2 | Q3 | Q4 | 2007 Q1

The Challenge	Getting Ready	Meeting The Challenge		Next Steps
Background	Mobilising the Market	Delivering Operational and Process Benefit	The Voice of the Customer	
The FSA Challenge	Issues that the Market Faced	Meeting the Targets	CCSC Assessment	
	Success Criteria	Addressing Exceptions		
		Addressing Legacy Contracts		

Contract certainty is delivering reduced operational risk, improved client service and improved process efficiency

- Improved clarity in process definition and responsibility.
- Improved contract checking.
- Increased development and use of operational management skills.
- Increased recognition and use of operational performance data.
- Greater use of independent checking and verification e.g. internal audit.
- Improved process effectiveness.

Placing process

- Earlier start to the placement and renewal process.
- Greater emphasis on provision of accurate information at an early stage in the process.

- Improved quality and completeness of placing documentation.
- Technical resource involved earlier in the process.
- Checking criteria more clearly defined.
- Improved clarity of insurers' exposures (model signing provisions).
- Improvements in clarity of placing documentation (abbreviation and ambiguity removed, subjectivities fully specified).

- Earlier calculation and notification of signed lines.
- Client receives evidence of cover earlier.
- Reduction in the level of rejection and rework.

At mid-year the Subscription Market survey found that 75% of market participants regard their systems & controls for achieving Contract Certainty to be either embedded or very well established in their business-as-usual operations.

The market has performed well against its self-set targets

In summary:

- **The Subscription market:**
  - Brokers are reporting 90% of contracts as certain at inception at October 2006
  - Brokers are reporting 82% of contracts as meeting the evidence of cover target at October 2006
  - Managing Agents are reporting 91% of contracts as certain at inception as at November 2006
  - Company market insurers are reporting 94% of contracts as certain at inception as at November 2006
- **The Non-Subscription market as at end October 2006:**
  - Insurers are reporting 88% of contracts as certain at inception
  - Brokers are reporting 89% of contracts as certain at inception
  - Insurers are reporting 89% of contracts as meeting the evidence of cover target
  - Brokers are reporting 77% of contracts as meeting the evidence of cover target
- **This performance is based on returns from subscription market firms* including LMBC, IUA and LMA members and returns from the non-subscription market covering 90% of the commercial market by premium income (insurers) and 100 BIBA and IIB members.**
- **Non-subscription issuance performance is improving but reported broker performance is below insurer data for three main reasons:**
  - Recording errors in broker back offices
  - Differences between insurer direct and broker-issued evidence of cover timelines
  - Insurer documentation errors.
- **The Non-Subscription market will continue to improve evidence of cover performance through such initiatives as Six Sigma process reviews, on-going dialogue between insurers and brokers, system developments and exception reporting analysis.**

Notes

- **The data shows contract certainty has gained momentum through 2006. Data has been provided from each constituency within the market. Each data set, although independently collated, is broadly supportive of the others.**
- **The data is based on clear guidelines issued to the market and a standard template for monthly reporting. It is envisaged that for the subscription market monthly reporting will continue throughout 2007.**

* ***Excludes PI clubs and non- IUA companies.***

As the level of contract certainty improved the industry focused on identifying exceptions and driving further progress

The results of the analysis concluded that:

- Exceptions are caused by a wide spectrum of issues.
- The way exceptions are measured varies between firms, as they interpret the CC guidance in the context of their specific operational risk management strategies.
- The late placement guidance is not applied consistently by all firms, again in accordance with operational risk profiles.
- The precise timing of the CC 'checkpoint' within measurement systems and the systems themselves can differ.
- Different classes of business and different geographies perform in different ways.

The Subscription market has demonstrated that there is not a strong relationship between the value of a contract and contract certainty failure.

Data from Managing Agents	June-Jul 06	Sep-Oct 06
Volume	1,459	886
Pass	0.85	0.84
Fail	1.22	1.16

Note : Figures are based on an average premium relative to a nominal value of 1. In other words, for June- July 2006, if the average value of premium for all risks was £100, the average value of contract certainty passes would be £85, the average value of failures would be £122. This implies that 81% of contracts by value are contract certain.

Data from Brokers Sep-Oct 06 **(representing 57% of industry)**	Pass	Fail
Broker 1	1.02	0.32
Broker 2	0.96	1.17
Broker 3	1.01	0.76
Broker 4	0.99	1.04
Broker 5	0.99	1.01
Broker 6	1.17	0.10
Broker 7	1.03	0.49
Broker 8	0.85	1.48
Broker 9	1.08	0.12
Broker 10	0.96	1.13
Broker 11	1.01	0.78

The Subscription Market is addressing Legacy contract reduction

Activity Undertaken

- Legacy priorities agreed.
- Legacy Code of Practice & Process Guidance issued (February 2006).
- Legacy pilots undertaken (e.g. JLT/BRIT, G6/Brokers).
- Progress made on reducing Priority 2/3.
- Changes underway to resolve Priority 1 numbers being wrongly represented (risks being added unnecessarily).
- LMA/LMBC Guidance Letter (November 2006).

Future Plans

- Implement recording/reporting changes for Priority 1 (from January 2007).
- Widen rollout of pilot legacy approaches during 2007.
- Confirm and achieve targets for 2007 legacy reduction. Target is to reduce legacy policies (in aggregate) to 60% by mid 2007 and to 40% by end 2007 from a baseline of mid 2006.

Note: Legacy is not a material issue for the Non-Subscription market.

AIRMIC asked its membership about the changes in timing of the completion of the various stages of the insurance renewal cycle

The following were reported in relation to the most recent renewal of their UK insurances:

- More than half the members responding to the survey reported that the renewal process now commences earlier than before the CC initiative.
- Collection and presentation of renewal information is commenced at least a month earlier by more than half the respondents.
- Review of policy wordings and discussion of coverage requirements also now take place earlier.
- More than half of AIRMIC members reported that evidence of cover is provided at least a month earlier than before the initiative.
- Finally, AIRMIC members reported that the issue of final policy wordings is being addressed as much as 3 months (or more) earlier.

Notes

- The feedback from AIRMIC members relates to the past renewal season.
- The data relates to a period of time over which the insurance industry was reporting a consistent improvement in performance.
- The data sample has a bias towards the earlier months of 2006.
- AIRMIC has committed to undertaking a further survey of its membership to assess progress in 2007.

The reported experience of AIRMIC members relates to the most recent renewal of their UK insurances

Class of Insurance	Average Premium	CC Achievement	UK Premium
Property Damage / Business Interruption	£1 to £5 million	66%	£820 million
Employers Liability	£250k to £500k	79%	£310 million
Public and Products Liability	£500k to £1 million	71%	£390 million
Financial Lines	£250k to £500k	71%	£260 million
Professional Indemnity / E & O	Up to £250k	77%	£220 million
Marine Cargo (Goods in Transit)	Up to £250k	79%	not available

Notes

- Renewal dates are spread throughout the year.
- For the period between December 05 and September 2006 the market average for subscription, open market contracts (based on broker returns) was 78%.

Meeting The Challenge

CCSC believes that the market has embedded contract certainty into its business

Key success criteria:
Improvement in processes and operational management capability
Percentage of contracts meeting contract certainty criteria
Extent of Senior management engagement
Affirmation by FSA of market view of progress
Extent to which firms understand exceptions.
Reduction in number of Legacy contracts
Ability to demonstrate that firms have embedded an effective measurement framework
Ability to demonstrate the development of a capability to sustain change
Making an Industry solution to contract certainty work.

- **100% of LMA, 100% of LMBC and 97% of IUA firms (Board level) have endorsed the guidance issued to the market setting out how firms should shape their approach to achieving contract certainty.**
- **Firms have confirmed (via liaison meetings/ consultations/ surveys/ helpdesk/ market sessions) that they have implemented the necessary systems and controls.**
- **The processes that firms have put in place have been reviewed by internal audit functions and/or external, independent reviewers; and/or (for smaller firms) line managers/compliance officers.**
  - **84% of Non-Subscription insurers and 73%* of Non-Subscription brokers have independently assessed their contract certainty procedures and reporting mechanisms.**
- **Firms are analysing exceptions (reasons, value) and using this data to improve contract certainty performance as part of continuous improvement.**
- **Technology developments have supported contract certainty e.g. Repositories, Model wording repositories, ACORD and XML standards, commercial tools, etc.**
- **There is improved awareness through training & education (incl. London Market Introductory Test) and tailored, approved CII training support).**

Momentum is more important than perfection – contract certainty is part of a journey – there are still things to be done.

** Note that the broker percentage includes returns from smaller firms who may not have independent audit or compliance support*

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There is a defined set of 2007 objectives for contract certainty

- **FSA Liaison**
  - Continue existing information flow for 2007.
  - Build on existing levels of CC performance.
- **Guidance**
  - Revise existing market guidance into a consolidated set in order to simplify, remove inconsistencies and ambiguity and improve clarity - strictly retaining the principles-based guidance approach (Q1 2007).
- **Measurement**
  - Establish new targets for 2007: firms to maintain levels of contract certainty at 90% or above through 2007 (Q1 2007).
  - Continue to reduce exceptions (end of Q2 2007).
  - Carry out a new survey on Subscription market in Q2 2007 to assess the extent to which CC is embedded.
- **Late placements**
  - Reduce late placements and demonstrate impact (Q4 2007).
    - Carry out further work to understand reasons for late placements* and identify where the industry can take further action to resolve.
    - Identify where action by AIRMIC and overseas regulators can help with addressing late placements.
- **Stamp conditions and subjectivities**
  - Continue to drive through agreed approach.
  - Develop plan to monitor reduction in usage.
- **Signed lines and signing provisions**
  - Review in the light of practical experience and incorporate into guidance consolidation project.
- **Legacy**
  - Devise and implement a coherent plan and monitoring regime to demonstrate significant reduction to the FSA.
  - Establish market-wide targets for reduction of each priority defined in the guidance. Target is to reduce legacy policies (in aggregate) to 60% by mid 2007 and to 40% by end 2007 from a baseline of mid 2006.

CCSC will continue its oversight through 2007.

For initial analysis see slide 24

Contract Certainty was never the end game, change will continue

Key success criteria:
Improvement in processes and operational management capability
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Making an Industry solution to contract certainty work.

- **The contract certainty challenge has established the capability to continue to improve and consequently momentum will be sustained:**
  - 2007 objectives are therefore important to provide focus for maintaining that momentum
- **Greater emphasis on professionalism and efficiency of operations function. Back office functions more visible to firms' senior management.**
- **Quality assurance on contracts earlier in the process.**
- **Identification of efficiency gains e.g. single evidence of cover, electronic placing initiatives.**
- **More client interaction, higher quality policies and improved understanding of those policies.**
- **Improvement in data collection processes and greater use by senior management.**
- **Improvement in quality assurance on individual risks.**
- **Continuing dialogue between insurers and brokers to understand reasons for contract certainty exceptions.**
- **Systems investments, process changes and training to underpin future improvement.**

The Subscription market has established a vision and forward agenda for reform for the next 3 years.

Reinforcing the industry's competitiveness by delivering a solution to contract certainty

In delivering on the contract certainty challenge the industry believes that it has demonstrated how, in conjunction with the FSA, a solution has been delivered that reinforces the competitive strengths of the UK insurance industry and maintains London's position as the pre-eminent market for complex commercial risks.

CCSC believes that the approach adopted has brought a number of significant benefits:

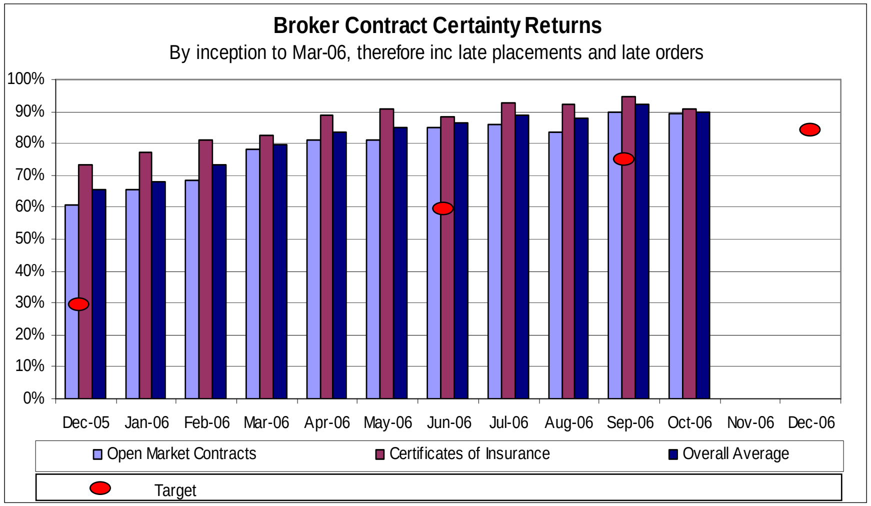
- **A catalyst for the further modernisation of the industry and a solution to addressing a threat to the efficiency and competitiveness of the UK insurance industry.**
- **An opportunity for the UK insurance industry to take a lead in an area that is a global issue.**
- **A solution to contract certainty that is commensurate with the risk faced.**
- **A set of guidelines that has quickly gained wide acceptance, because they had been built by the industry, for the industry.**
- **A set of guidelines compatible with the FSA's existing regulatory powers.**

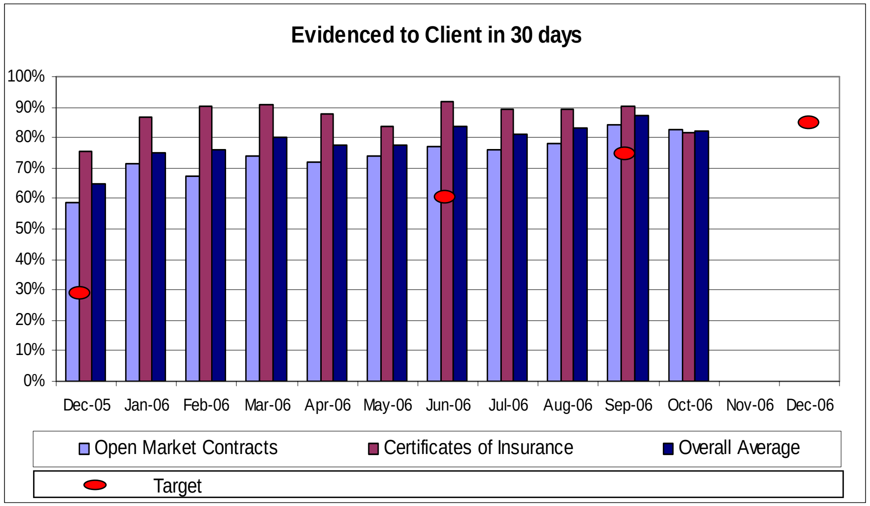
Appendix A - Data

Broker Contract Certainty Report

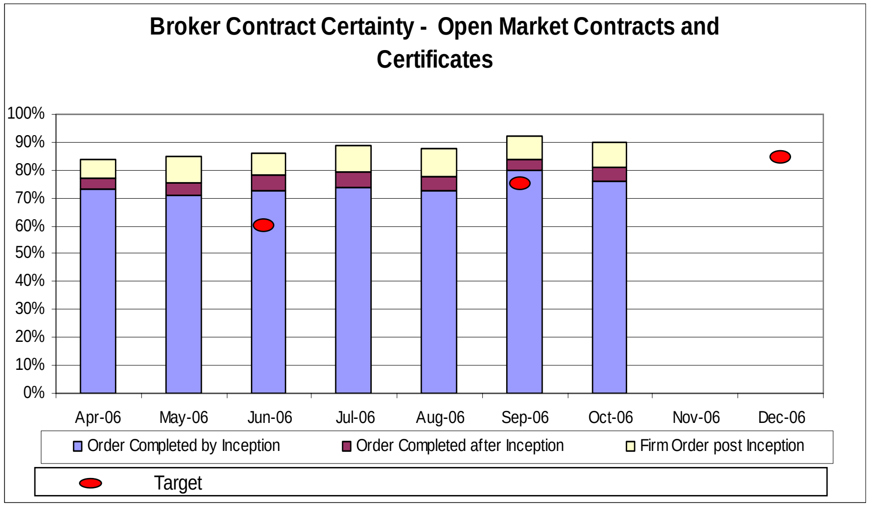
Summary

- Brokers' self-assessed score for open market October returns stands at 89%. There has been a increase in performance from an initial 61% in December 2005.
- Brokers' self-assessed score for certificates of insurance October returns stands at 91%. There has been an increase in performance from an initial 73% in December 2005.
- Brokers' self-assessed score for issuance of Evidence of Cover October returns stands at 82%. There has been an improvement in performance from an initial 65% in December 2005.





Broker Contract Certainty Returns – breakdown for incomplete and late placements

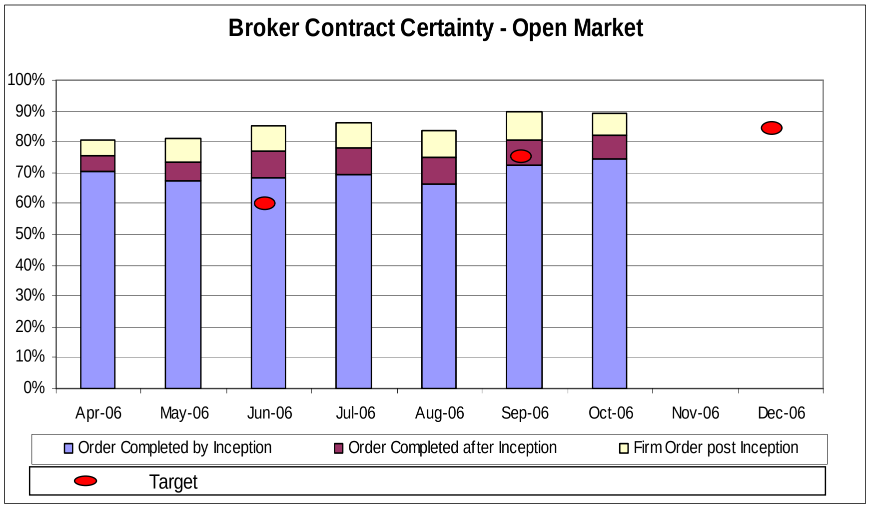


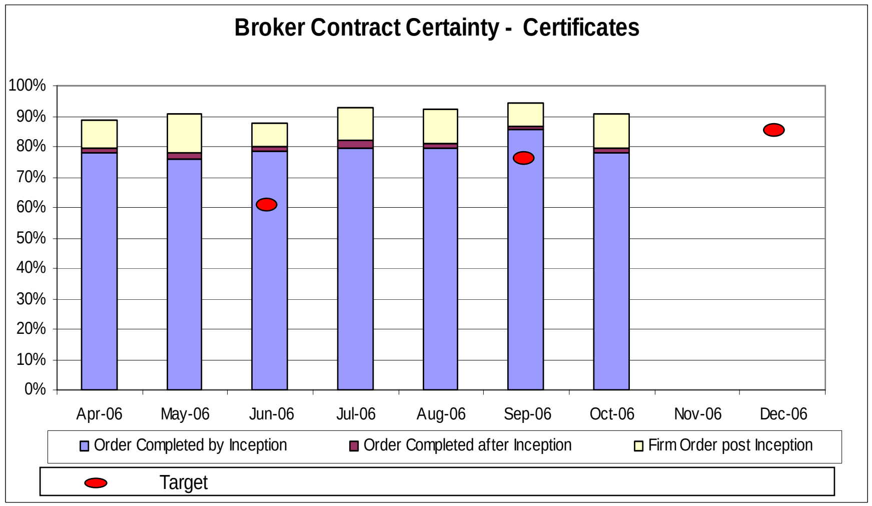
Key observations on the data

- **Order completed by inception October returns stands at 76%.**
- **Order completed after inception October returns stands at 5%.**
- **Firm order post inception October returns stands at 9%.**

Reasons for late placement include:

- **Poor practice by client, intermediary, broker or insurer.**
- **Buying strategy of client or intermediary.**
- **Unavailability of information.**
- **Reserving of capacity for aerospace risks.**
- **Length of value chain and associated degree of control by London.**





Data

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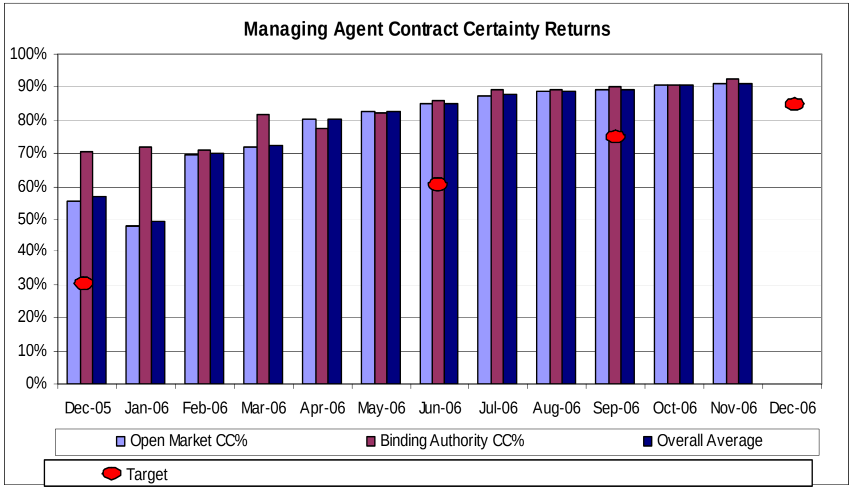
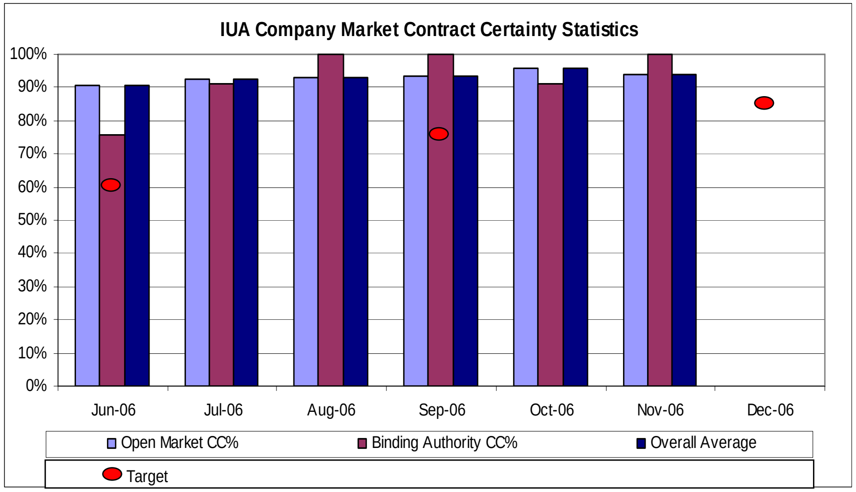
Data from Managing Agents and Companies continues to support Broker data

Managing Agent Contract Certainty



- **91% - Total Contract Certainty in Nov ’06**
- **Improvement in performance from 57% in December 2005**
- **91% - Open Market in Nov ’06**
- **Improvement in performance from 56% in December 2005**
- **93% - Binding Authority in Nov ’06**
- **Improvement in performance from 71% in December 2005**

Company Market Contract Certainty

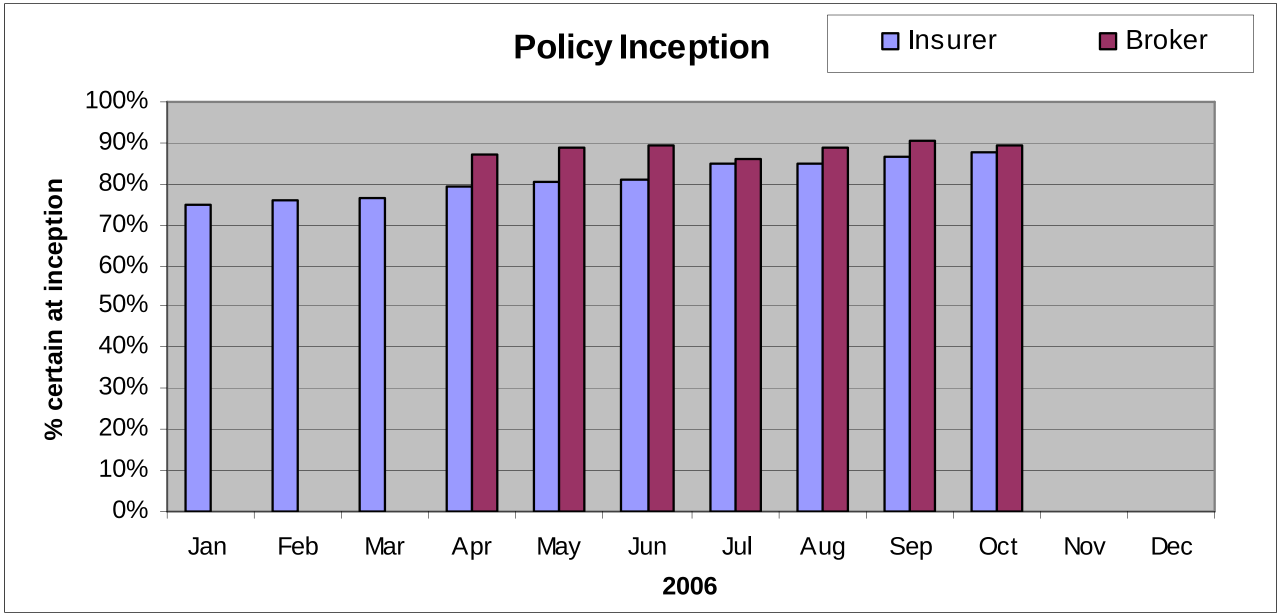


- **94% - Total Contract Certainty in Nov ‘06**
- **Improvement in performance from 91% in June 2006**
- **94% - Open Market in Nov ‘06**
- **Improvement in performance from 91% in June 2006**
- **100% - Binding Authority in Nov ’06**
- **Improvement in performance from 76% in June 2006**

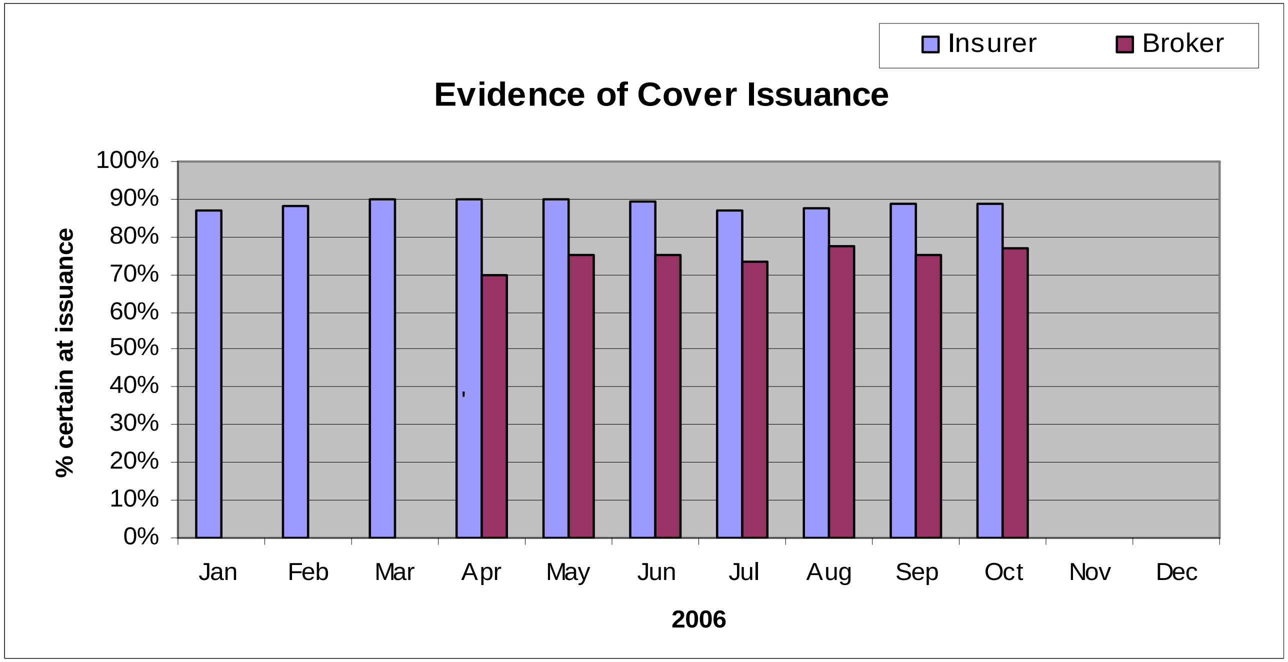
Data

Contract Certainty Steering Committee

Non-subscription market performance: good progress



Insurers and brokers are, respectively, reporting 88% and 89% of contracts as certain at inception.



Insurers and brokers are, respectively, reporting 89% and 77% of contracts as meeting the evidence of cover target.

Data

Non-Subscription Market data - commentary

Insurers

- Returns received from insurers representing 90% of the Commercial market by premium income.
- Average policy sample 190k per month.
- Steady improvement in certainty performance at policy inception and renewal as firms continue to drive process, system and behavioural improvements.
- Evidence of cover standards rose in September but impact of late instructions, late proposal forms and late confirmations is affecting ability of many firms to achieve higher standards .

Brokers

- Returns received from c100 BIBA and IIB members.
- Average policy count 53k per month.
- Certainty performance at inception and renewal steady at c90%.
- Evidence of cover performance is improving but remains below the reported insurer data for three main reasons:
  - Recording errors in broker back offices.
  - Differences between insurer direct and broker-issued evidence of cover timelines.
  - Insurer documentation errors.

The Non-Subscription market will continue to improve evidence of cover performance through such initiatives as Six Sigma process reviews, on-going dialogue between insurers and brokers, system developments and exception reporting analysis.