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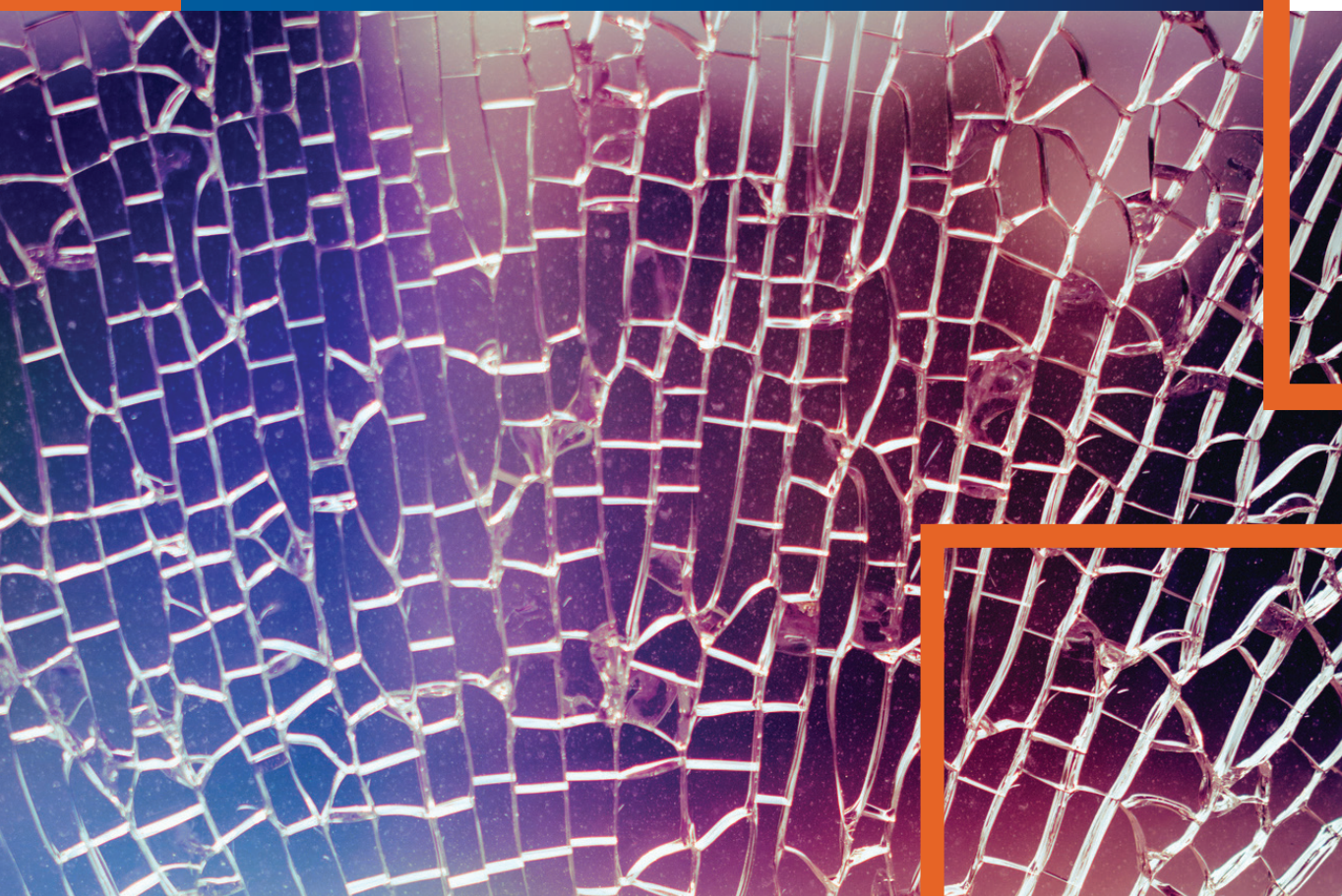
A practical cross-border resource to inform legal minds

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Navigating the Risks of Enhanced Underwriting

Lloyd's Market Association



Ray Koh

The Lloyd's Market Association (LMA) report *The Growth of Enhanced Underwriting in the Lloyd's Market: The New Normal?*¹ published in November 2024, articulated the momentum behind new models that support more automated, data-enriched and scalable underwriting. The report provided a classification of enhanced underwriting models, which are now in active use across the market. The architects of these innovations promise better risk selection, reduced frictional costs and a more agile London market. Often referred to as enhanced or algorithmic underwriting, these approaches offer operational efficiencies and are reshaping how risks are selected, priced and bound.

Such developments mark a departure from the traditional model in which underwriters individually assess and negotiate risks. Under enhanced underwriting models, those functions are transferred into system architecture, reducing or removing human intervention.

To support the models, managing agencies rely on existing placement frameworks, including binding authorities, line slips and consortia, as the supporting contractual infrastructure. This chapter on the risks of enhanced underwriting looks at this contractual infrastructure. While the technology may be new, the contractual frameworks are not.

Same Old, Same Old: The Underpinning Structures

There is a temptation to present enhanced or algorithmic underwriting as a radically new development. Perhaps the technology is new. However, enhanced underwriting continues to rely on time-tested legal constructs, such as the delegation of authority to coverholders or co-insurers. The legal structures, though applied within new systems and enriched data environments, remain unchanged. Many of the legal questions also remain unchanged: Who has the authority to bind? Are they allowed to delegate under Lloyd's rules? Who does what and to what extent should they be held accountable for it? Who is the agent of whom?

A Quick Refresher

Line slips

Line slips have long been used in Lloyd's as a mechanism for a broker to place a series of similar risks efficiently. Rather than presenting each risk to multiple syndicates, the broker obtains agreement from a lead underwriter on a risk within the agreed parameters, which have themselves been agreed by all the syndicates, and the risk is declared to the line slip, which automatically binds the following markets on the line slip. They are often used for homogeneous, lower value or high-volume risks. A common misunderstanding is that authority is delegated to

a broker under a line slip. This is not the case. A line slip is the delegation of authority from followers on the line slip to the lead. A "broker line slip" may have been put in place to enable risks from that broker to be insured by participants on the line slip, but the fact remains that the line slip itself does not delegate authority to the broker.

Consortium agreements

Consortia represent another method of joint underwriting within Lloyd's. Consortia are very similar to line slips. Under a consortium, one managing agent, known as the consortium manager, underwrites risks on behalf of a group of participating syndicates under a common agreement and is responsible for the administration of the agreement. A consortium is an internal Lloyd's arrangement among managing agents as to how risks are going to be accepted to the consortium. The consortium will have its own consortium number, which is used on the contract instead of individual syndicate references. Individual syndicates remain the contracting parties for their respective shares of risk.

Consortia are often used to underwrite specialist or complex classes of business where collaboration and shared expertise are desirable. Consortia therefore involve a pooling of underwriting capacity and expertise, with the consortium manager empowered by agreement to bind all members. Similar to a line slip, the followers delegate authority to the consortium manager.

Binding authorities

A binding authority is fundamentally different in that both the lead and following underwriters delegate underwriting authority to a third-party coverholder, usually an intermediary. The coverholder is authorised to enter into contracts of insurance on behalf of the syndicates within clearly defined limits set out in the binding authority agreement.

At the most limited end of the spectrum, "prior submit" or "limited" binding authorities require the coverholder to seek approval for each risk. Each syndicate retains decision-making power and instructs the coverholder to bind.

At the broader end, underwriters provide a defined appetite within which the coverholder may bind risks autonomously. The degree of granularity in this appetite may vary depending on the nature of the business and the comfort level of the underwriters involved.

One of the key distinctions between a binding authority and the line slip and consortium is money. Generally, third-party coverholders handle money on behalf of the underwriters.

They receive money from the retail or producing broker and then distribute it to the managing agent. With line slips and consortia, the money is passed directly to the managing agent.

Blurring of Placement Models

Automated facilities, where the system decides which risk to bind based on defined appetite, have traditionally used binding authorities. This is the default mechanism because the act of binding is delegated to a third party.

However, we understand that there is growing interest in using consortia and line slips as vehicles for enhanced underwriting, particularly in scenarios where the act of binding is carried out not by the lead underwriter personally, but instead by a system or platform operated by a third party under their control. This may be because of a perception that consortia and line slips are easier to put together and process than binders. A point to note is that if the system is not owned by the line slip lead or consortium manager, there is usually a sub-delegation of binding authority to the owner of the system.

We also understand that there are some coverholders that rely on the consortium model when it comes to the processing of premiums. What this means is that the premium is sent directly to underwriters instead of via the coverholder. Therefore, the coverholder only needs binding authority without the need to have authority to hold money on behalf of the underwriters. From the underwriter perspective, it means less delay and friction in receiving money. And, of course, a reduction in risk.

The Problem With Sub-Delegation

Complexities can arise when authority is sub-delegated; for example, where a line slip lead delegates authority to a coverholder. Each tier of sub-delegation increases the difficulty of managing authority, audit trails and governance.

Delays often result from this lack of proximity. Information must travel through multiple intermediaries, each potentially operating under different systems. If a piece of mail takes 24 hours to be forwarded by a person, multiple links in the chain mean that it will take longer to reach its ultimate destination where it is to be actioned.

Influence and control also become harder. If you only delegate once, you only have to convince one party that your way is the correct way. This is not the case if you have sub-delegation, when you rely upon your lead to convince the ultimate lead or party with authority.

From a claims perspective, the ultimate claims lead may not be the lead that you originally followed; for example, where a line slip takes a following position. Admittedly, this is not an issue that is restricted to sub-delegation.

Ultimately, these inefficiencies undermine the speed and certainty that enhanced underwriting structures are supposed to deliver.

It should be noted that the template binding authority agreement and the template consortium agreement do not allow sub-delegation from the respective leads unless approved by all the followers. There is no such parallel provision in the line slip.

The Template Agreements

Binding authority agreements – particularly the market standard LMA3113 – offer some clarity as to the roles and responsibilities of the parties involved. That is not to say that LMA3113 is perfect, especially since the original LMA3113 was built before insurance was truly digital. However, it can be amended to fit today's models. The level of amendment required is a function of the risk appetites of the respective parties. Coverholder and underwriters alike should be aware that the LMA is leading a project to rewrite LMA3113 as the

Computerised Binding Authority Agreement as part of the LMA Delegate Authority Reimagined strategy. Watch this space!

The Lloyd's consortium agreement, LMA3145, was largely based on the Lloyd's standard binding authority agreement LMA3113. However, as noted above, consortia are delegations of authority to the lead underwriter to bind risks on behalf of the followers. It is not a contract of delegation to a third party, although such delegation is permitted with the permission of the followers.

Line slips, despite their extensive use, often lack clear frameworks specifying the role and obligations of the parties and that is even before we throw in the added complexity of enhanced underwriting. Typically, the line slip lead takes on certain functions implicitly, but these obligations are rarely explicitly defined, even where a lead's fee is charged.

Of course, duties of the lead can be reframed as the rights of the followers: How do followers access underwriting data? What does the lead do in terms of financial crime checks? Does the lead carry out any regulatory or conduct due diligence beyond what is required for its own line; for example, in relation to broker remuneration or subscription market brokerage? Currently, these and other questions lack answers in the standard template. They are important because whenever we talk of duties and rights, what happens if those duties are not fulfilled or the rights not granted? Who is liable? These questions are valid for all risks declared to the line slip, not just for those written under an enhanced or automated model. These questions are not abstract – they are current. Just because duties and rights are not articulated, it does not mean that they do not exist and if the duties attendant on the line slip lead are not articulated, the lead may find later on that it was always under a duty to undertake such tasks, possibly in court. Setting out such duties and rights properly in a line slip could be seen as risk management for the line slip lead.

Potential services that could be provided by line slip leads

Underwriting and wording stewardship

- Review of proposals and risk details.
- Wording review.

Financial crime and sanctions

- How any potential hits or concerns are escalated and how followers are informed, understanding that it is difficult for one managing agent to accept the role of sanctions risk checking on behalf of another.

Regulatory and conduct due diligence

- Licensing issues.
- Complying with conduct requirements such as product oversight and consumer duty.
- Identifying and managing potential conflicts of interest between broker and underwriters; for example, payment of subscription market brokerage.

Information and oversight

- What will be shared with followers, in what format and with what frequency?
- Followers' rights to request additional information, attend audits or review individual files.

Operational and external interface

- Whether the lead acts as first point of contact for claim notifications and how it interfaces with any separate claims lead arrangements.
- The extent to which the lead will coordinate or support responses to Lloyd's or other regulators on matters relating to the line slip, or whether each follower is expected to deal with regulators independently.

We are not saying that all of these activities must be carried out by the line slip lead on behalf of followers. Note that there are some activities that simply cannot be delegated, such as sanctions checking and, as the regulations stand at the time of writing, product oversight. However, what is true is that tasks undertaken by the lead on behalf of the followers, such as underwriting the risk, engaging with the broker, and interrogating structure and fees, all require time and expertise. Line slip followers benefit from that work when they follow the lead, even if it is not expressly undertaken for them. In that sense, followers enjoy the economic benefit of the lead's activity without contributing to its cost.

The same issue arises one level up if the line slip lead itself follows an open market lead that is completely outside the line slip, particularly through an algorithmic fast-follow system. In that scenario, the open market lead is carrying the cost of underwriting and negotiation for the entire market, while the line slip lead and its followers simply mirror the result. The platform provider is remunerated, the producing broker is remunerated and the line slip lead may charge a lead's fee within the facility, but the open market lead whose work underpins the whole arrangement may receive nothing beyond its own line. Where followers or facility leads wish to rely on that work in a more structured way, it becomes a commercial question of how, if at all, the cost of that effort should be recognised and shared.

The economic and governance questions are only one part of the picture. The other is what legal remedies followers in fact have when things go wrong.

Misrepresentation and the Rights of Followers

In a traditionally placed subscription market risk with a lead and followers, the broker presents the risk to the lead and followers. If a misrepresentation is made, the lead and followers may have a remedy, including avoidance, because the misrepresentation is likely to have been made to each of them.

In a traditional binding authority or line slip, where the coverholder or line slip lead binds risks on behalf of the entire following market, any misrepresentation made to that coverholder or line slip lead is likely to be imputed to all subscribing underwriters for whom they act. This is because the coverholder or line slip lead is authorised to act on behalf of the followers. Witness evidence may, of course, still be needed from following underwriters to work out what remedy might apply, but the essential point still stands.

However, the position is less clear in fast-follow facilities where the binding authority or line slip is itself designed to follow an open market lead. In a fast-follow situation, the followers are not receiving a presentation; they are merely following the decisions of an open market lead. In such cases, if a misrepresentation is made only to the open market lead, can the followers under the binder or line slip, including the coverholder and line slip lead, rely on it to avoid the risk, in circumstances where the open market lead is not acting on behalf of any other party when underwriting, and where a presentation was not made and assessed by either the coverholder or line slip lead? In those circumstances, there is no knowledge, or lack thereof, of the coverholder or line slip lead to impute to the followers on whose behalf they act.

Case law in this area is not definitive because it sits uneasily with the basic legal structure of the subscription market. Each subscribing underwriter is party to a separate contract with the insured, so that a single slip or policy evidences a bundle of separate contracts, one per underwriter, rather than one composite contract. Section 24(2) of the Marine Insurance Act 1906 makes this explicit. In principle, a separate duty of fair presentation is owed to each subscribing underwriter and the question whether there has been an actionable breach needs to be answered separately for each underwriter.

Courts have taken a pragmatic approach in subscription cases where a misrepresentation or non-disclosure has been made to the lead. The courts have accepted that followers may, in practice, be influenced in different ways. Some followers may assess the risk independently. Others may, in their assessment of risk, rely substantially on the lead's judgment, such that if the lead was misled, the following market is treated as having been misled as well.

In the fast-follow context, where the followers are unlikely to have made any assessment of that particular risk, the core question is whether they can rely on any misrepresentation or non-disclosure to the open market lead, who underwrites entirely for its own account and outside any facility. Absent a clear agency relationship between the open market lead and the facility participants, there is a risk that a court may be reluctant to treat non-disclosures made solely to the lead as non-disclosures to all, because the followers are bound through a facility that binds risks automatically without any assessment or review of the presentation materials.

One possible solution lies in a clause such as LMA5262, which was drafted as part of a suite of clauses for the Insurance Act 2015. LMA5262 sets out as follows:

"If, before the conclusion of this insurance contract, the Insured has made any material misrepresentation to any leading insurer underwriting the terms on which this insurance contract is also underwritten, the Insurer shall be deemed to have relied upon such misrepresentation when underwriting this insurance contract and may therefore have a remedy against the Insured for breach of the duty of fair presentation."

If language such as this were endorsed on to the declaration at the time that the facility line is entered on to the risk, this may resolve the issue of whether the followers have a remedy for misrepresentation where such is made to the open market lead only. Even better, replace the reference to the duty of fair presentation with something less English and you have a clause that may persuade a foreign court, assuming the policy is subject to non-English law, to adopt the same position as to followers as it does to a lead.

"Wording Failure"

One structural feature gaining traction in algorithmic facilities is appetite-based auto-following, where platforms bind risks to followers based on pre-declared appetite parameters. These facilities automatically bind underwriters as followers to risks led by an open market lead.

But what happens if the follower is bound to a risk that falls outside its declared appetite? Such a situation could arise out of simple negligence in risk selection, or as a result of a wording failure.

A wording failure scenario – the ineffective exclusion

If a follow facility underwriter's appetite is defined by the effectiveness of an exclusion in the contract wording (agreed by an open market lead), the facility underwriter could find themselves on cover for those kinds of risks it intended to avoid if such exclusion is not enforceable. A concrete example could arise because of exclusions. In many territories, exclusions have to be dealt with in a certain way to be enforceable. Under French law, for example, Article L.113-1 of the *Code des assurances* requires that exclusions be "formal and limited" (*formelles et limitées*) to be valid. Additionally, Article L.112-4 requires that such exclusions be expressly brought to the attention of the insured at the time of contracting. Any failure to comply by an open market lead underwriter may result in the exclusion not being effective. Similar requirements for exclusions to be enforceable exist in other countries.

Country	Requirement(s) for Validity of Exclusion Clauses	Relevant Statute/Code/Legal Basis
Spain	Exclusions must be highlighted (e.g. special font, bold) and expressly accepted by the insured.	Law 50/1980 (Law on Insurance Contracts).
Italy	In standard form contracts, any onerous, unusual or particularly burdensome exclusion or limiting clause must be specifically approved in writing by the insured.	Article 1341 of the Italian Civil Code and Legislative Decree 209/2005 (<i>Codice delle Assicurazioni Private</i>).
Portugal	Exclusions must be clear, unambiguous and must be brought to the insured's attention.	Decree-Law 72/2008 (Insurance Legal Regime) and general contract law (<i>Código Civil Português</i>).

In a situation where a wording failure scenario has caused the deviation from appetite, liability could turn on who was responsible for the wording. If the coverholder or line slip lead drafted or approved the wording, liability may follow.

The position becomes less clear when the binding authority or line slip is designed to accept declarations following an open market lead. If a misalignment arises from a wording failure, where the wording has been agreed by the open market lead, who is to blame? The open market lead quite rightly bears no responsibility for the followers. Whether or not any liability attaches to the coverholder or the line slip lead depends on the scope of delegation.

To state the obvious, if your appetite is very loosely defined, it is going to be difficult to fall outside of appetite. Consider, for example, an appetite to mirror the movements of a specified underwriter. In such cases, the expectation is clear as the follower is knowingly aligning with another party's risk appetite and decision-making, with little room for ambiguity (see number 1 in the table below). However, as the matching becomes more granular, for example, to follow "specialty risks", the potential for a difference between the actual and the expected increases (number 2). For example, what one underwriter classifies as specialty may differ from another's interpretation. This is not a new problem. Reinsurers have had to deal with the concept of "incidental non-marine" on marine reinsurance treaties in the past.

Number	Appetite	Risk of Deviation
1	"All risks written by open market lead underwriter x".	Risk selection error.
2	"Specialty risks written by open market lead underwriter x".	Risk selection error.
3	"Specialty risks written by open market lead underwriter x that exclude y".	Risk selection error/ wording failure.

Example number 3 is where a wording failure, as detailed above, could arise because the appetite match is dependent upon an exclusion being effective.

What all this means is that unless the platform or the lead of the follow facility is tasked with validating the risk and the wording, the followers, including the lead of the follow facility, may not be able to say with certainty that the specified appetite will be met in all cases. The result could therefore be a vacuum of accountability where things go wrong in this way.

Underwriters need to take care when defining their appetite and go into these arrangements with their eyes open. Are they happy to define appetite widely and accept that they are, in substance, blind followers of an open market lead? Or do they want more granular selection criteria and an additional layer of due diligence? If the latter, they need to be clear about the extent to which the party selecting the risk will validate the risk. In other words, conduct due diligence. Identify who that party is in practice (the open market lead, the coverholder, the line slip lead, the platform) and what happens if that work is not done. That means agreeing not only how the model matches appetite, but also what validation, if any, is carried out on the underlying risk and wording and what information will be shared back to followers. That additional wording needs to be set down somewhere. Equally, if the lead does not want to undertake those tasks on behalf of the followers but is happy doing those tasks for its own purposes, then that should also be set out. All of this is the age-old legal concept of allocation of liability. Before you get to that allocation, you need to work out who is responsible for what and for whom.

Conclusion

And that is the call to action for underwriters: as a lead, what obligations are you taking on to followers? And as a follower what do you expect your lead, or coverholder, to do for you? Write it down in an agreement. Then you have a basis for figuring out what should happen if things go wrong. There is basic contract certainty between the parties.

The Lloyd's Claims Lead Arrangements, formerly the Lloyd's Claims Scheme, reflect that kind of thinking in the claims context. They spell out who does what between the first lead and second lead, and what happens when someone gets it wrong. There are boundaries, responsibilities and even caps on liability. In short, there is a playbook.

So why not for underwriting where there is delegation? Why not at least consider similar concepts, especially for line slips, that address who is responsible for risk validation, documentation review or providing the information for financial crime checks, for example?

Underwriters need to be confident that due diligence on new risks is being performed, either by the line slip lead, the coverholder or themselves. But what they cannot afford is a vacuum, a situation where no one is doing it because everyone assumed someone else would. That is an operational failure waiting to become a legal dispute.

Endnote

- 1 <https://lmalloyds.com/the-growth-of-enhanced-underwriting-in-the-lloyds-market-the-new-normal>



Ray Koh joined the Lloyd's Market Association in September 2022. Ray is responsible for the wordings trainee scheme as well as participating in the day-to-day legal work at the LMA.

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The Lloyd's Market Association (LMA) exists at the very heart of Lloyd's, a world-leading global marketplace for complex risk where solutions to challenges are delivered every day. 59 Lloyd's managing agents and members' agents are members of the LMA.

We represent our members' interests to organisations including governments, regulators and the market's central supporting body, the Corporation of Lloyd's. We provide professional and technical expertise in areas ranging from model policy wordings to the implementation of innovative technologies. We connect with our members to identify and resolve issues facing the market, and work in partnership with Lloyd's and the other market associations to influence initiatives and outcomes. We operate the market's most comprehensive technical education service, the LMA Academy. For more information visit our website.

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