

Lloyd’s Reinsurance Coverholder

Category: Opinion 22 November 2017

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Since Lloyd’s is a market for insurance and is not a company, establishing its presence in a particular jurisdiction is done in an unconventional way. Unlike foreign insurance companies that establish a local office in a country, doing business with

Lloyd’s is done through brokers and one particular mode is known as the “coverholder model”. It has also become a scheme to “making the London market more easily available on a global scale”. Coverholders, for Lloyd’s itself, is a distribution channel. As of 2016, there are about 2,500 Lloyd’s coverholders producing 30% of Lloyd’s premium income each year. 85% of coverholders have been with Lloyd’s for more than 5 years. Total premium written by Lloyd’s coverholders in the U.S. in 2010 was approximately \$2 billion.

This coverholder system allows Lloyd’s to operate in a region or country as if they were a local insurer, even without a physical presence. Risks are assumed directly by Lloyd’s underwriters. In the risk handling process, the coverholder is responsible for placing the risk. The coverholder informs the broker who in turn informs the managing agent of the risk.

Because Lloyd’s enjoys an excellent reputation with high ratings, the coverholder system for Lloyd’s has been accepted in a number of jurisdictions. Moreover, Lloyd’s offers specialized covers or special classes of insurance or niche products that are not offered by other insurance firms or are just too risky for insurers to accept. This may include underwriting personal accident cover for famous sports personalities or specialty liability insurance. It may include underwriting risks “that are too large, or too complex, or both, that do not lend themselves to coverage through more ‘normal channels’”.

An alternative way of obtaining Lloyd’s coverage is through the Open Market Correspondent’s (OMCs). An OMC is an insurance intermediary in designated territories that introduces business to Lloyd’s.

Coverholder is a “company or partnership authorized by a managing agent to enter into a contract or contracts of insurance to be underwritten by the members of a syndicate managed by it in accordance with the terms of a Binding Authority.” It is an insurance intermediary that acts in all respects as the actual insurer. On the other hand, a binding authority or a “binder” “is an agreement between a managing agent and a coverholder under which the managing agent delegates its authority to enter into a contract or contracts 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.” It is negotiated annually. A delegated underwriting authority may also

come through a Lloyd’s Service Company that is a 100% owned subsidiary of a Lloyd’s managing agent.

A binding authority agreement may also delegate the coverholder with the authority to issue insurance documents on behalf of Lloyd’s syndicates. It can also spell out the coverholder’s other responsibilities, such as the handling and collection of insurance premiums or the settlement of claims. Thus, the relationship between the coverholder and the syndicate is one of agency. The relationship with the coverholders is regulated by the *Lloyd’s Revised Code of Practice on Delegated Underwriting* and by the Financial Conduct Authority (FCA) Handbook and other Lloyd’s minimum standards.

It has been said that coverholders “have the pen” (underwriting pen), i.e. “they can bind coverage from a syndicate without going to London and waiting to see an underwriter at the syndicate’s box at Lloyd’s.” Needless to say, coverholders have an enormous responsibility and their role is “based on a sense of trust”. Managing General Agents (MGA) would “have to be very careful in deciding who gets that authority” as a coverholder. Syndicates commit their risk capital, on annual basis, through the binding authority contract. Thus, the syndicates agree to participate on all the risks the coverholder underwrites over the course of one year.

The selection of a coverholder is approved by Lloyd’s upon the sponsorship of a managing agent. To be approved as a coverholder requires a tedious application process that takes into consideration the applicant’s experience, financial capacity, and other legal requirements. The coverholder operates on a commission basis.

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