

Market Bulletin

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Title	Consultation Paper – Merging the Franchise Board into the Council
Purpose	The Council and the Franchise Board (the “Board”) are consulting with members and with all participants in the Lloyd’s market on a proposal to merge the Board into the Council to create a single governing body for the Corporation and the Lloyd’s market
Type	Consultation
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Date	08 May 2019
Deadline	The Consultation is open until 30 June 2019

Consultation Paper

Merging the Franchise Board into the Council

1. Introduction

The Council and the Franchise Board (the “Board”) are consulting with members and with all participants in the Lloyd’s market on a proposal to merge the Board into the Council to create a single governing body for the Corporation and the Lloyd’s market.

The proposal has the unanimous support of the members of both the Council and the Board.

The governance of the Corporation and the market is a relatively complex topic. This Consultation Document therefore sets out the background issues and explains –

- The composition of the Council;
- The establishment of the Board;
- The operation of the Board and Council; and
- The statutory constraints on the composition of Council.

The Consultation Document then goes on to set out the Council and Board’s proposal on –

- The optimum composition of Council;
- The optimum composition of Council within the statutory constraints;
- The establishment of an Underwriting Advisory Committee; and
- Consultation and implementation.

The Council and the Board invites you to carefully consider the Council and Board’s proposals and the questions set out in section 4 below.

This is an important issue and the Council and Board therefore invite you to submit written responses to the Secretary to the Council by no later than 30th June 2019. Responses may be sent by post to –

Peter Spires
General Counsel
Secretary to the Council & Franchise Board
Lloyd’s
One Lime Street
London
EC3M 7HA

Or by email to peter.spires@lloyds.com

If you have any questions on this Consultation Document please contact Caroline Sandeman-Allen, the Head of Secretariat & Governance on 020 7327 6182 or by email to caroline.sandeman-allen@lloyds.com.

This Consultation Document has been sent to all members of the Society, to all managing agents, all members' agents, all Lloyd's brokers, and to the Association of Lloyd's Members, the High Premium Group, the Lloyd's Market Association and the London & International Insurance Brokers' Association. The Consultation Document has also been sent to the Prudential Regulation Authority and the Financial Conduct Authority.

2. Background

2.1 Composition of Council

The Council of Lloyd's was established by Lloyd's Act 1982. It comprises three categories of Council member –

- Working members –
 - A working member (including a non-underwriting working member) is a member of the Society who occupies himself or herself principally with the conduct of business at Lloyd's by a Lloyd's broker or underwriting agent.
 - They are elected from amongst the working member constituency on a one member one vote basis.
 - In 1982, there were originally 16 working members of Council. There are currently 6.
- External members –
 - An external member is either a corporate member or an individual member who is not a working member.
 - Corporate members (companies, SLPs and LLPs) must appoint an individual as its nominated representative if elected.
 - External members are classified as either "individual external members of the Council" (essentially representing "unaligned capital") or "C-external members of the Council" (representing "aligned capital").
 - In 1982, there were originally 8 external members of Council. There are currently 6.
 - The number of individual external members of the Council is set by reference to the proportion of unaligned to aligned capital. Since this proportion dropped below 10% in 2018, there is currently only 1 individual external member of Council.
 - External members of Council are elected from amongst the external members of the Society on a capacity weighted basis. Further weighting is applied so that, effectively, individual external members of Council cannot vote for C-external members and vice versa.
- Nominated members –
 - These members cannot be members of the Society or have other close ties with the market.
 - In 1982, there were originally 3 nominated members of Council. There are now 6 including the Chairman of Lloyd's and the Chief Executive Officer.

- They may be regarded, for the purposes of the UK Corporate Governance Code, as independent members of Council, with the exception of the Chairman of Lloyd's and the Chief Executive Officer.

The current rules for the Council are set out in Lloyd's Act 1982 which can be found here https://www.lloyds.com/market-resources/requirements-and-standards/acts-and-byelaws/lloyds_acts

and in the Constitutional Arrangements Byelaw which can be found here <https://www.lloyds.com/market-resources/requirements-and-standards/acts-and-byelaws/lloyds-byelaws>

2.2 Establishment of the Franchise Board

With the changing nature of Lloyd's, particularly the reduction of Names and the introduction of corporate membership, considerable ingenuity has had to be applied to make the Council construct operable. This has led to a number of reports on the subject including the Task Force Report, the Morse Report, the Pen Kent Report and the Chairman's Strategy Group ("CSG") report. However, on analysis, whilst there would be considerable obstacles to removing the statutory requirement for the Council to exist there are relatively few statutory constraints on its make-up. These are dealt with below.

The CSG considered the governance of the Society in 2002. In summary, it stated that decision making at Lloyd's had been slow and based on trying to build consensus amongst constituencies with diverse interests. It sought to streamline Lloyd's governance which at that time operated in a tri-partite structure comprising the Council and its two sub-committees the Lloyd's Market Board (LMB) and the Lloyd's Regulatory Board (LRB). The LMB and LRB had in turn established their own sub-committees such that at the time of the CSG there were 21 committees involved in the running of the market.

The CSG's recommendations included the establishment of the Board. The Board is therefore a creation of the Council and no reference is made to the Board in Lloyd's Acts.

The Board met for the first time in 2003 and now comprises –

- The Chairman of Lloyd's;
- the Chief Executive Officer, the Performance Management Director and the Chief Finance Officer (the executive directors);
- 3 insurance professionals connected with the Lloyd's market (connected non-executive directors); and
- 6 individuals who are independent of the Lloyd's market (independent non-executive directors).

2.3 Operation of the Board and Council

The Board has operated well in conjunction with the Council over the last 15 years. However, the operation of both bodies does lead to duplication and, on occasion, to questions around which body should undertake specific activities. Experience suggests that no matter how carefully the terms of reference between the bodies are set up, these questions will always arise. Governance reports have noted that the two bodies have been effective but have not always been efficient.

Having two governance bodies also makes Lloyd's more difficult to explain to its stakeholders and to external parties such as regulators and potential new entrants.

Lloyd's is currently consulting on the "future at Lloyd's" which is aiming to make the operation of the Lloyd's market much more efficient and both the Council and the Board felt that now was also a good time to simplify the governance of the market.

2.4 Statutory constraints

Lloyd's Act 1982 provides that "There shall be a Council of Lloyd's" so, without statutory amendment, the Council must continue to exist.

There is no realistic prospect of statutory amendment at this time. The aim now is to ensure that the governance structure is as efficient as possible with the optimum membership composition. To achieve this, it is proposed to merge the Board into the Council.

The powers of the Council would not change – they are set by statute – rather those functions which had been delegated by the Council to the Board would be brought back into the remit of the Council and the composition of the Council will be revised in line with the proposal set out in section 3.2 below.

With the benefit of assistance of leading counsel Lloyd's has explored the extent of the flexibility admitted by Lloyd's Act 1982 to the composition of the Council in terms of the number of members required from each constituency.

The absolute minimum number of Council members from each constituency, is 1. This would however not be practicable. It would, for example, give the 1 working member a veto on the passing of any special resolution (required for the passing of byelaws and other key decisions) which requires separate majorities of working members and non-working members (external and nominated members taken together). It would also limit the choice of Deputy Chairman (Lloyd's Act 1982 requires that if the Chairman of Lloyd's is not a working member then one of the Deputy Chairmen must be). It would also generate problems for succession planning and in the event that any of the members was conflicted on a matter. Accordingly, in practice, the minimum number of members from each constituency is 3.

3. The Council and Board's Proposals

3.1 The optimum composition of Council

The Council and the Board have given careful thought to the optimum composition of a revised Council having regard to the need to –

- properly represent market constituents without becoming too inwardly focussed;
- set strategy having regard to developments in the Lloyd's insurance market, the insurance market worldwide and other global trends in commerce, technology and macro-economic developments;
- understand and engage with governments and regulators worldwide and bring insights from our key and emerging markets;
- draw from the Council ideal candidates to chair and populate essential committees including Audit, Risk, Nominations and Remuneration;
- appoint Deputy Chairmen and a senior independent director;
- reflect principles of good corporate governance (including the UK Corporate Governance Code), to balance elected members with non-elected members and the requirement that at least half the board excluding the chair should be independent non-executives;
- keep the Council at a workable size; and
- make the best use of existing members of Board and Council and allow Lloyd's to continue to attract the best talent and to promote diversity and inclusion in line with Lloyd's targets.

3.2 The optimum composition of Council within the statutory constraints

The Council and the Board have concluded, subject to consultation, that the following composition of Council would offer the optimum composition within the statutory constraints.

- Nominated members – a minimum of 9 and a maximum of 11. This would comprise–
 - The Chairman of Lloyd's (and chair of the Nominations Committee);
 - The Chief Executive Officer (who would not count as independent);
 - The senior independent director (and chair of the Remuneration Committee);
 - Individuals who can also chair the Audit and Risk Committees;
 - Individuals with regulatory, government and international expertise;
 - Individuals with experience of technology and change management;
 - Individuals with insurance market expertise from outside the Lloyd's market
 - A sufficient number of independent members to ensure they would always be in the majority in accordance with good corporate governance standards.

- Working members – 3. This would comprise –
 - At least one individual who works for a managing agent; and
 - At least one representative of a Lloyd's broker;

- External members – 3. This would comprise –
 - One individual to represent unaligned capital; and
 - Two individuals to represent aligned capital one of whom would be a Deputy Chairman.

- Additional attendees – the Chief Finance Officer and the Performance Management Director.

This would give Council an overall size of up to 17 members (19 with the additional attendees) which is comparable to the existing size of Council (18) but considerably fewer than the 27 members of Board and Council combined.

The appointment process for members of Council would continue to be governed by the statutory framework which requires that the working and external members of Council be elected from among the working and external members of the Society and that nominated members be appointed by special resolution of the Council.

It is proposed that initially the Chairman of Lloyd's would work with the Nominations and Governance Committee to identify the best combination of nominated and elected members from amongst the existing members of Council and Board to populate the newly constituted Council. Both the Council and the Board support this process.

This will mean that certain elected members of the Council's terms of office may be concluded ahead of time on 31 December 2019. Adopting this process may avoid the need to hold Council elections for 2020 which will provide for better continuity as the new arrangements bed down. Arrangements would be adopted so that, in the ordinary course, in any one year one working member and one external member would be elected each for a 3 year term.

The existing committee structure of the Council and Board will remain unchanged albeit they will all become committees of the Council.

3.3 Underwriting Advisory Panel

The Council and the Board also propose to establish an Underwriting Advisory Panel as a committee of the Council to provide the Council and the Performance Management Director with regular, structured and externally informed views on insurance issues. This will also help to ensure that underwriting experience currently on the Council and the Board is not

lost in the implementation of the proposals. It is proposed that the Council will appoint members of the Underwriting Advisory Panel after receiving a recommendation from the Nominations & Governance Committee.

3.4 Consultation and implementation

As mentioned above, this is an important issue and, therefore, this Consultation Document has been sent to all participants in the Lloyd's market with the consultation remaining open for an 8 week period. This period has been timed to coincide with the annual general meeting in order to allow members an opportunity to raise any questions they may have at that forum.

Lloyd's has kept the Prudential Regulation Authority and the Financial Conduct Authority informed of these proposals and will continue to work closely with them throughout this process.

The Council and the Board will consider the feedback from the consultation including the responses it receives to the questions set out in section 4, during July.

If, following careful consideration of the feedback, the Council and Board decide to implement the proposals (or modified proposals), this will involve –

- The Council amending the Lloyd's Constitutional Arrangements Byelaw;
- The Chairman of Lloyd's working with the Nominations and Governance Committee to identify the best combination of nominated and elected members to serve on the revised Council as referred to above;
- Council elections may, or may not, need to be held in the normal way at the end of 2019; and
- The Nominations and Governance Committee will review the effectiveness of the new arrangements after 18 months of operation.

4. Questions

Question 1.

Do you agree with the basic proposal to merge the Board into the Council to create a single governing body for the Corporation and the Lloyd's market ? If so, do you agree that this should happen with effect from 1.1.2020 ?

Question 2.

Do you agree with the criteria set out in paragraph 3.1 for the optimum composition of a revised Council ? Are there any factors that have been overlooked ?

Question 3.

Do you agree with how the criteria of the optimum composition of a revised Council have been converted into the proposal set out in paragraph 3.2 ? In particular

- a. do you agree with the proposal to have 3 working members ?*
- b. do you agree with the proposal to have 3 external members ?*
- c. do you agree with the proposed make-up of the nominated members ? and*
- d. do you agree with the proposed overall composition of the revised Council ?*

Question 4.

Do you agree with how Lloyd's proposes to identify the best combination of nominated and elected members from amongst the existing members of Council and Board to populate the revised Council ?

Question 5.

Do you have any other comments or observations on the proposals ?

If you have any questions on this consultation document please contact Caroline Sandeman-Allen, the Head of Secretariat & Governance on 020 7327 6182 or by email to caroline.sandeman-allen@lloyds.com.