

Market Bulletin

LLOYD'S

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SUBJECT: NEW TAX RULES ON GENERAL INSURANCE RESERVES:
INFORMATION REQUIREMENTS
ATTACHMENT: **Annex**
ACTION POINTS: **For information**

New tax rules have been brought in relating to general insurance reserves and Lloyd's RITCs. The rules, which impose a form of discounting, operate by reviewing a member's tax deductions with hindsight. This bulletin gives guidance on the arrangements that will be needed for managing agents to provide members with information that they need for tax purposes.

The new tax rules apply when a member writes 4% or more of a syndicate's stamp, with the participations of companies within the same ownership being aggregated for this purpose. Participations of less than 4% are not affected by the new rules.

The tax legislation requires managing agents to provide information to members so they can comply with their tax obligations. The attached guidance note sets out the information that will have to pass between managing agents and members so this can happen. We are grateful to the Inland Revenue for reviewing this guidance in draft.

This bulletin is being sent to all underwriting agents, auditors, direct corporate members, personal accountants and members who deal with their own tax affairs. If you have any queries, please contact Helen Hope on extension 6839 or myself on extension 5228.

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NEW DISCOUNTING REGULATIONS GUIDANCE ON INFORMATION ARRANGEMENTS AT LLOYD'S

Introduction

1. Section 107 Finance Act 2000 and the General Insurance Reserves (Tax) Regulations 2001 (SI 2001/1757) introduce the new discounting regime for the taxation of general insurers in the UK. This note outlines administrative arrangements for tax reporting under the new discounting rules, and in particular the information that will have to flow between managing agents and members.
2. The new regime applies to any Lloyd's member, whether corporate, SLP or individual, who writes 4% or more of a syndicate's stamp. To be caught by the new rules the member must write 4% or more both of the syndicate that cedes the RITC and of the syndicate that accepts the RITC. The legislation also applies to any corporate member who would exceed this threshold if the holdings of connected companies are aggregated.
3. Corporate members first have to make discounting calculations in their tax computations for accounting periods beginning on or after 1 January 2001. In most cases this will be for calendar year 2001. Any individuals affected by the new rules will first have to make calculations for the income tax year 2001-02. In both cases the syndicate results taken into account will be those for the 1998 year of account (plus calendar year 2000 run-offs of earlier years). The discounting calculations will go back to the closing RITC for the 1997 year of account.
4. The new legislation applies to the calculation of the *member's* taxable profit or loss. It does *not* affect the determination of the syndicate's taxable result. The managing agent will agree the syndicate's taxable result with the Inland Revenue without regard to discounting.

Obligation on managing agents to provide information

5. The Regulations require that a managing agent shall, on request from a member or former member of the syndicate, provide the member with the information that it needs to make a discounting calculation in respect of its syndicate share. This can, however, only be information that is within the managing agent's possession or power (Regulation 7(11)).
6. A member has to recalculate each year, with hindsight, the liabilities for each previous year of account until those liabilities are completely run off. To do so, it must aggregate the syndicate results and adjust for member-level items, such as reinsurance purchased by the member. As part of this process, the member has to convert syndicate-level year of account data on the development of liabilities and claims payments into its own member-level years of account based on the years in which it

joined or left a syndicate or adjusted its participation. The Inland Revenue has devised a “matrix approach” for this, spreadsheets for which, together with detailed guidance notes on the legislation, are on its website at www.inlandrevenue.gov.uk/specialist/gir.htm.

7. A feature of the new legislation is that a member can disclaim for tax purposes part or all of the closing RITC (or in the case of a run-off syndicate, part or all of the closing provision made for known and unknown outstanding liabilities) if it wishes. This has the effect of increasing the taxable profits (or decreasing the tax loss) in the year for which the disclaimer is made. If made, the disclaimer automatically reverses in the following year, so the taxable profits for that year will be reduced by the amount of the prior disclaimer plus interest under the discounting calculation. However, the member may also make a disclaimer for that following year, and so on. Members may opt to make disclaimers for any reason, including to match the discount they expect under the new hindsight rules. The first disclaimers can be made in relation to the closing RITC for the 1997 year of account, and the time limit for this will be by 31 December 2002 in the case of a company with a calendar year accounting period.
8. Members who are affected by the new discounting rules will need to request, and managing agents will need to provide, information so they can meet their tax obligations. Not all the relevant information is, however, in the possession or power of the managing agent. For example, the managing agent may not know whether one corporate member is connected with another. It is therefore the responsibility of the member to decide whether it is caught by the statutory threshold of a 4% participation on a syndicate. If it is caught, the member should then request the information that it needs.
9. The managing agent will need to provide the requesting member with:
 - (a) a breakdown of the liability development for the syndicate, set out by year of account and if requested by Lloyd’s currency (see paragraphs 10 – 18 below);
 - (b) details of any “retrospective reinsurance contracts”, as defined in the legislation, entered into during the year. This is necessary so the member can comply with anti-avoidance provisions in the Regulations (see paragraphs 19-20 below).

Syndicate data on development of liabilities

10. The breakdown of claims development from the managing agent will provide the following information covering each syndicate year of account that has closed or gone into run-off. The information must be broken down by the original year of account in which the syndicate wrote the business, and will show:
 - (a) the RITC accepted in the later year of account (if any);
 - (b) the closing RITC for the later year of account; and

(c) claims paid, net of reinsurance, including claims handling costs during the later year of account.

11. The managing agent will have to provide the information separately, where requested for any earlier year, for liabilities written in any of Lloyd's prescribed currencies under the Syndicate Accounting Byelaw (i.e. US dollar, Canadian dollar and sterling, with any non-US and non-Canadian liabilities being included in the sterling calculations). If, however, a member does not elect to have the data on either US dollar or Canadian dollar liabilities in those currencies, that information must be provided in sterling.
12. For example, in calendar year 2003, which follows the closure of the 2000 year of account, the managing agent will on request have to supply members with the data relating to the development of syndicate business in the 2000 year of account. This data needs to show, in relation to liabilities that the syndicate assumed in each earlier year of account, the amount of the RITC received (or opening reserves), the RITC paid (or closing reserves) and the claims payments relating to those liabilities. In each case the information must be available separately, if requested, in US dollars in relation to US dollar business and in Canadian dollars in relation to Canadian dollar business. In 2003, the earlier years' business for which this information will be needed are: (a) 1997 and prior years of account business (which are treated as one figure for this purpose); (b) 1998; and (c) 1999.
13. In calendar year 2003 the managing agent will also need to give the member information on the amount of the closing RITC or reserves (split into prescribed currencies if requested) that relate to pure year business that the syndicate first wrote in the 2000 year of account. This will become the baseline for future discounting calculations relating to the 2000 liability year. The member needs the information as it can disclaim for tax purposes some or all of the closing RITC. Where a disclaimer is made, the member has to specify which original liability years and which currencies the disclaimer is for. (In this example it could relate to any combination of sterling, US dollar or Canadian dollar liabilities for any or all of the 2000, 1999, 1998 or 1997 and prior years of account.)
14. It is expected that the managing agents will provide syndicate information on the development of liabilities in a summary form. Members will then have to convert it into their own member-level data. This is because a member who, for example, first comes onto a syndicate for the 2000 year of account and accepts liabilities of an earlier syndicate year of account by way of RITC will in reality be writing those liabilities as new business. The Inland Revenue has provided spreadsheets entitled "Lloyd's – allocation of claims and provisions calculator" which will re-allocate syndicate year of account claims, provisions and RITCs to a member's own years of account, and these are available at the website address given in paragraph 6 above.
15. In drawing up syndicate data to provide to members, managing agents may have to make certain statistical assumptions or allocations. For example, a reinsurance contract may cover liabilities denominated in more than one currency, or liabilities relating to more than one year of account and it will be necessary to allocate it appropriately. The Regulations provide that for these purposes "any necessary

apportionment shall be made and the method of apportionment adopted shall...be just and reasonable” (Regulation 9).

16. The Inland Revenue can therefore require a member to show that any apportionment made in calculating the discounting adjustment is fair and reasonable. Members may therefore request managing agents to outline any assumptions used, or for sight of the calculations underlying the summary data, and managing agents will be expected to provide it to them.
17. One further item of information that a member needs to calculate the amount of the discounting adjustment is the date on which claims are settled. The Regulations allow statistical methods to be used, and the Inland Revenue guidance notes say on this point that:

“An example of a statistical method that may often be appropriate would be the use of an assumption that all claims paid in a period of account were paid exactly half way through the period. The method must be expected to give approximately the same result as the individual calculations – this requirement would rule out a method that introduces a consistent bias.”

Members may therefore need to ask managing agents for details of the dates of syndicate claims settlement or statistical averages so they can use the appropriate information in their tax returns. The same may be true of any other statistical methods that are used to provide data to the member.

Syndicate mergers

18. Where two or more syndicates merge, the members of the old syndicates will need to have syndicate data furnished to them according to when they first wrote the business at syndicate level. So, for example, if syndicate 123 merged with syndicate 456 to form a new syndicate 789 for the 2000 year of account, members of the old syndicates will need data that distinguishes the old 123 liabilities from the old 456 liabilities. A 123 member will be treated as having first written the 123 liabilities in the earlier years of account but as having first written old 456 liabilities if and when the 2000 year reinsured earlier years to close. The data that the members put into the “Lloyd’s – allocation of claims and provisions calculator” spreadsheets referred to above need to reflect this distinction.

Information on “retrospective reinsurance contracts”

19. Managing agents will also need to inform members of any “retrospective reinsurance contracts” that the syndicate entered into with respect to liabilities of earlier years of account so the member can comply with anti-avoidance provisions in the Regulations. A “retrospective reinsurance” for this purpose is any reinsurance (other than a Lloyd’s RITC) that reinsures liabilities that have already been the subject of a tax deduction – i.e. that have already formed part of an RITC or the closing provisions for a syndicate at the 36-month or subsequent points.

20. If a syndicate enters into a “retrospective reinsurance” with a reinsurer that is a connected company of a syndicate member, certain anti-avoidance provisions apply. Managing agents need therefore to inform members as a matter of course of the identities of the reinsurers of any retrospective contracts. If a member then identifies that a reinsurer is a connected company of theirs, the managing agent will have to furnish further details so the anti-avoidance rules can be applied by the member (and by the reinsurer) as required.

Forecast of claims development

21. As noted above, members have the right to disclaim part or all of the closing RITC or reserves for a year of account for tax purposes. They may choose to do this for any reason, including matching the forecast development of liabilities on a discounted basis. A member may want to see whether it would be beneficial for it to pay more tax up front by making a disclaimer rather than have to pay tax on deemed receipts (or greater deemed receipts) in later years under the hindsight discounting rules.
22. In order to model the effects of the discounting legislation and the potential effects of disclaimers a member will need, among other information, data on the forecast development of the liabilities on its book of business. It may therefore ask managing agents if they are able to provide them with such data. Under the terms of the standard managing agents’ agreement the managing agent is required to provide this service.
23. In order to assist members and managing agents who want to model liability development but who may not have access to sufficient data, Lloyd’s Market Reporting and Analysis Department will be able to provide, on request, triangles showing Lloyd’s market-wide claims development by class of business. These triangles will show quarterly developments and are expected to be available in the first quarter of 2002. Triangles showing annual developments are currently available. Requests for data should be made to james.corr@lloyds.com.

Contact point

24. If you have any comments or queries arising from this note, please contact me at david.clissitt@lloyds.com, or Helen Hope at helen.a.hope@lloyds.com

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