

FROM: Head of Admissions EXTN: 5743
DATE: 30 March 2005 REF: Y3533
SUBJECT: **AGENCY AGREEMENTS - TERMINATIONS AND VARIATIONS
RELATING TO PROFIT COMMISSION TERMS**
SUBJECT AREA(S): (1) Procedures for making applications to increase fees
and/or profit commission, merge syndicates or undertake a minority buy-out
for the 2006 year of account.
(2) Procedures relating to applications to vary profit commission terms for
aligned members.
ATTACHMENTS: No

ACTION POINTS: **Underwriting agents to note**
DEADLINE(S): **30 April 2005 for applications
17 June 2005 for full applications
The above deadlines only apply to subject area 1 of this Bulletin**

Agency Agreement Terminations

This bulletin sets out the procedures to be followed by underwriting agents when making an application to:

- increase its fees and/or profit commission (see Appendix 1); or
- effect a syndicate merger (see Appendix 2); or
- effect a minority buy-out (see Appendix 3).

All of these applications require managing agents to apply to the Admissions Department by no later than 30 April 2005 for conditional consent to terminate the agency agreements. The deadline for submission of full applications relating to increases in fees and/or profit commission is 17 June 2005.

Core information

All the above applications must include the following core information:-

- rationale for the proposed transaction giving rise to the agency agreement termination; and
- details of discussions held with members' agents and members.

Lloyd's no longer requires the following additional core information to be supplied in support of these applications:-

- details of the syndicate(s) concerned and the members' syndicate premium limits;
- details of the underwriting members to whom the notice is proposed to be given; and
- the name of members' agent(s) through whom notice is to be given.

This Bulletin replaces the Agency Agreement terminations bulletin dated 23 March 2004, reference number Y3271.

Aligned Syndicates

Where a managing agent of an aligned syndicate wishes to obtain conditional consent to terminate agency agreements under the Advanced Consent Regime (bulletin dated 14 August 2003, reference number Y3116), it should write to Lloyd's with brief details of the proposals, including written evidence that the proposals have been agreed by the board of the corporate members participating on the relevant syndicate. Lloyd's will then acknowledge and comment if necessary.

Variations relating to profit commission terms

Lloyd's issued a bulletin on 22 April 2004 reference number Y3298 on the impact of FRS5 and is aware that some managing agents may wish to vary the terms of the managing agents' agreements for aligned members to reduce profit commission. Full details of how Lloyd's proposes to deal with applications to vary profit commission terms in the managing agents' agreements are set out in Appendix 4 to this bulletin.

Queries

Any queries relating to fee and profit commission increases or mergers should be referred to the Admissions Department either:-

- Reshma Handa (tel: 0207-327-5625, email: reshma.handa@lloyds.com);or
- Nigel Williamson (tel: 0207-327-6415, email: nigel.williamson@lloyds.com).

Any queries relating to minority buy-outs should be referred to Capacity Markets either:-

- Jonathan Rees (tel: 0207-327- 6225, email: jonathan.rees@lloyds.com);or
- Richard Miller (tel: 0207-327-5897, email: richard.miller@lloyds.com).

Any queries relating to the variation of profit commission terms should be referred to the Admissions Department:-

- Nigel Williamson (tel: 0207-327-6415, email: nigel.williamson@lloyds.com).

This bulletin has been sent to all underwriting agents, approved run-off companies, Lloyd's brokers, Lloyd's market associations and recognised accountants.



Matthew Chandler
Head of Admissions
Risk Management

APPENDIX 1

Fee and profit commission increases

1. Managing Agents

Managing agents should make applications in accordance with paragraph 11B of the Agency Agreements Byelaw (No. 8 of 1988) (the “Byelaw”). In the interest of transparency the terms of reference that will be used to determine applications for the 2006 year of account are set out at Schedule 1 of this Appendix. The detailed requirements for applications are set out at Schedule 2 to this Appendix.

Managing agents should provide members’ agents and direct corporate participants with a copy of their application and give them 21 days from point of despatch to make representations to the Admissions Department. Where further information is required to be submitted to the Admissions Department, this must also be sent to the members’ agents and direct corporate participants, and should allow them a further 7 days from the point of despatch to consider the information and to make further representations.

It is in the best interests of managing agents, members and Lloyd’s if agreement in respect of terminations of managing agent’s agreements can be reached. Managing agents should therefore hold discussions with members regarding their fee proposals before submitting their application to the Admissions Department. It is incumbent on managing agents and members to use their best endeavours to ensure that this process has been followed as part of their application.

2. Members’ Agents

Members’ agents should make applications in accordance with paragraph 11A of the Byelaw. Applications should include details of the fees and/or profit commission currently charged by the members’ agent and the amount by which it is proposed to increase them. Members’ agents should also include in their application the items of information listed in Schedule 2 to this Appendix which are asterisked.

Members’ agents should provide members and corporate participants with a copy of their application and give them 21 days from point of despatch to make representations to the Admissions Department. Where further information is required to be submitted to the Admissions Department, this must also be sent to the members and corporate participants and should allow them a further 7 days from the point of despatch to consider the information and to make further representations.

It is also advised that members’ agents consult with their members prior to submitting any application to terminate the members’ agency agreement.

Schedule 1 – Terms of Reference

Terms of reference for the consideration of applications made by managing agents under paragraph 11B of the Byelaw for permission to give notice to terminate standard managing agent’s agreements in respect of proposed increases in fees and/or profit commission.

1. In determining whether an application for consent to terminate the standard managing agent’s agreement in respect of a proposed increase in fee and/or profit commission should be granted, the Franchise Board must be satisfied that the increase is reasonable in that it will not materially adversely affect the rights of members who participate on the syndicate in question (or the value of those rights) or, if it does, that such effect is objectively and reasonably justified.
2. The burden of satisfying the Franchise Board of the above matters is on the managing agent.
3. Every application will be determined on its merits in a consistent manner having regard to all relevant matters including:
 - a) the rights of the members to participate on the syndicate in question;
 - b) the fees previously charged by the managing agent; and
 - c) the information submitted by the managing agent in support of the application.
4. Each application must be approved by the managing agent’s board of directors and must include supporting information in accordance with the “Requirements in Respect of Applications for Permission to Give Notice to Terminate Standard Managing Agents Agreements Relating to Fees and/or Profit Commission Increases” attached at Schedule 2 to this Appendix.

Schedule 2 - Requirements in respect of applications for permission to give notice to terminate standard managing agent's agreement relating to fees and/or profit commission increases

- * *These requirements are also relevant to members' agent increase in fee applications.*

The application shall include the following additional information:

- *Details of the proposed increase in fees (expressed as a monetary amount and as a percentage increase).
- * The impact of the proposal on members stating their current position and their position following the proposal in monetary and percentage terms.
- The reason(s) why the increase in expenditure should not be treated as a syndicate expense.
- *Certified copy extracts of all board minutes which refer to the proposed increase in the fee or which record discussion of it.
- *A statement of the commercial or business case for the proposed fee increase including and cross referring where necessary to supporting budgets and estimates in respect of any proposed increased expenditure. The information shall be presented in such a way as to clearly show to which managed syndicates and to which years of account any proposed increase in expenditure will relate and shall include an explanation of the benefit that will accrue from the proposed increase in expenditure in respect of each managed syndicate.
- *Details of the annual fee and/or profit commission (expressed both as a percentage and as a monetary amount) charged or to be charged by the agent for all managed syndicates for the current year of account and for each of the three preceding years of account (estimated figures may be provided where actual figures are not yet available).
- Details of the expenditure incurred or to be incurred and not recharged to the syndicate by the managing agent for all managed syndicates for the current year of account and for each of the three preceding years of account, together with details of the period over which any material or exceptional items of expenditure are to be amortised (estimated figures may be provided where actual figures are not yet available).
- Details of the budget for the managing agent and for each of the syndicates managed by the managing agent for the current year of account and the estimated budgets for future years of account, up to and including the first year of account in which it is considered by the managing agent that members of the relevant syndicate will begin to derive benefit from the proposed expenditure. This information must also include a statement of the period over which any material and/or exceptional items are to be amortised.

- Details of any changes in the syndicate allocated capacity of the relevant syndicate for the current year of account, for each of the three preceding years of account and any proposed changes.
- A copy of the agent's policy for the allocation of syndicate expenses which should include an explanation of the basis on which expenses arising from profit related remuneration payable to directors and consultants are allocated. This should highlight any changes made to the policy over the last three years and any proposed changes to be made to the policy.
- Particulars of any proposed acquisition or disposal by the agent - or any connected company or any connected person - of rights to participate in the relevant syndicate (whether through the auction or under any other scheme or arrangement as may be permitted from time to time by Lloyd's for that purpose).
- Particulars of any proposed transactions by the agent or any connected company or connected person for the purpose of effecting any change in participation in syndicates, including but not limited to any transaction falling within the scope of the Major Syndicate Transactions Byelaw (No 18 of 1997).
- *Any additional information that the agent considers to be relevant to the application.

Merger Applications

Managing agents should make applications in accordance with paragraph 11B of the Byelaw. Lloyd's consent to an application to terminate the managing agent's agreement as a result of a syndicate merger will be conditional upon completion of the syndicate merger. Detailed requirements for the provision of additional information in respect of applications relating to syndicate mergers is attached at schedule 1 of this Appendix.

Managing agents should provide members' agents and direct corporate participants with a copy of their application and give them 21 days from point of despatch to make representations to the Admissions Department. Where further information is required to be submitted to the Admissions Department, this must also be sent to the members' agents and direct corporate participants and agents should allow them a further 7 days from the point of despatch to consider the information and to make further representations.

Provided that Lloyd's has granted conditional permission to terminate, managing agents shall, no later than 17 June 2005, send to the Admissions Department, members' agents and direct corporate participants, the additional detailed information set out in this schedule. Members' agents must pass the information and documents received from the managing agent to their members within 7 days of receipt and advise them that they may attend a syndicate meeting convened for the purpose of discussing and voting on the proposed merger. Votes may be cast by proxy or post.

Schedule 1 - Detailed requirements for the provision of additional information in respect of applications relating to syndicate mergers

The managing agent should supply the following additional information, together with any other information necessary to enable members to make a properly informed assessment of the proposed merger and its effect on the members concerned:

- An explanation of the basis on which, and the amounts in which, rights to participate in the successor syndicate for the following year of account are to be allocated among the members of the ceasing syndicate and the members of the successor syndicate for the current year of account.
- Particulars of plans for participation in the successor syndicate by members who are associates of the managing agent of the successor syndicate.
- Confirmation by the managing agent of the successor syndicate that it intends to effect a reinsurance to close of the ceasing syndicate by the successor syndicate.
- A copy of the syndicate annual report to be prepared in the current year for each syndicate concerned in respect of 2004 year of account.
- A copy of the proposed business plan for the successor syndicate for the 2006 year of account including details of the economies of scale anticipated by the merger with specific regard to the reinsurance programme and investment income (or a summary thereof specifying the person from whom copies of the proposed business plan can be obtained free of charge).
- The identity of the active underwriter of the merged syndicate, particulars of his or her experience demonstrating his or her competence to manage the merged syndicates and particulars of his or her contract of employment.
- Before and after organisation charts for the merged syndicates.
- The manner in which the operations of the separate syndicates will be combined following the merger, identifying changes in resources, procedures, management and its reporting and allocations of responsibilities.
- Details of how the independent and peer review process will operate in the merged syndicate.
- Details of the IT systems used by each of the merging syndicates and how these systems will operate post merger, or how the information will be migrated onto a single IT system post the merger, including timeframes.
- Composition of the combined syndicate following the merger in terms of aligned/unaligned capacity and any intentions to make a minority buy-out.
- Particulars of the managing agent's plan in the event that the merger proposal is unsuccessful.

- A declaration from the directors of the managing agent as to the accuracy of information provided in the form prescribed in Schedule 1, paragraph 2(8) of the Major Syndicate Transactions Byelaw.
- Any additional information that the agent considers to be relevant to the application.
- Changes to individual registrations required.
- Applications for multiple syndicates' permissions for underwriters.
- Confirmation that revised terms of reference have been prepared for Sub-Committees, New Underwriter etc.

APPENDIX 3

Minority Buyouts

Any underwriting agent that wishes to effect a minority buy-out for the 2006 year of account must apply to Lloyd's Admissions Department by 30 April 2005 for conditional consent to give conditional notice of termination under the managing agents' agreements in order to effect minority buy-outs.

Managing agents should make applications in accordance with paragraph 11B of the Byelaw and Schedule 2, paragraph 2 of the Major Syndicate Transactions Byelaw (No. 18 of 1997). Permission to terminate the managing agent's agreement will be conditional upon completion of the minority buy-out. The application should include details of the proposed surrender arrangement or share swap arrangements.

Managing agents should provide members' agents and direct corporate participants with a copy of their application and give them 21 days from point of despatch to make representations to the Admissions Department. Where further information is required to be submitted to the Admissions Department, this must also be sent to the members' agents and direct corporate participants and agents should allow them a further 7 days from the point of despatch to consider the information and to make further representations.

Requests for minority buy-outs are considered by the Capacity Transfer Panel. Guidance on minority buy-outs is set out in Regulatory Bulletin 041/2000 "Guidance on Minority Buy-outs" issued on 18 April 2000.

Applications to vary profit commission terms

Following the issue of Application Note G “Revenue Recognition” to FRS5 “Reporting the Substance of Transactions” (see Lloyd’s Market Bulletin Y3298 of 22 April 2004) Lloyd’s has received a number of queries from managing agents asking whether they may vary the terms of the managing agent’s agreement for aligned members to reduce the profit commission payable to nil. The requests received have been both to apply such a change retrospectively to the 2003, 2004 and 2005 years of account, and to apply it for future years.

Paragraph 5(9) of the Byelaw requires that for any given year of account the same provision for profit commission shall apply to the managing agent’s agreement between the managing agent and each member of the syndicate.

Lloyd’s considers that it is important that members of a syndicate year of account are treated equitably and accordingly, that a managing agent applies the same terms for fees and profit commission in its managing agent’s agreement with each of those members. However, Lloyd’s also recognises that there may be circumstances where varying profit commission terms for an aligned member may be of benefit to the member’s controller(s) without adversely affecting the unaligned members.

Lloyd’s will therefore consider applications from managing agents for consent to vary profit commission terms in managing agents’ agreements under the Byelaw.

In order to obtain consent from Lloyd’s under the Byelaw, the managing agent must be able to satisfy Lloyd’s that it fully meets its obligations to all members. Set out below is the best practice procedure for agents to follow to ensure that they meet these obligations, but managing agents may present alternative notification arrangements which may be adopted if Lloyd’s is satisfied of their suitability.

The suggested procedure is as follows:

1. submit to Lloyd’s a comprehensive application setting out:
 - full details of its proposal to amend the profit commission together with the rationale;
 - details of aligned members that are the subject of the application;
 - confirmation that the proposal will not adversely affect the unaligned members;
 - confirmation that the reduction in the profit commission will not adversely affect (i) the managing agent’s revenue and its ability to perform its role properly and (ii) its ability to comply with Lloyd’s financial resource requirements;
 - confirmation that the managing agent has advised the direct corporate participants and members’ agents who represent the unaligned members of the syndicate (see paragraph 2 below).
2. *[at the same time that the managing agent makes the application under paragraph 1 above]* send a copy of that application to the relevant direct corporate participants and members’ agents. The direct corporate participants should be advised they have 21 days to respond. The managing agent must inform the members’ agent(s) that they have 7 days to forward the application to the relevant members, incorporating

any commentary they consider appropriate. The members have a further 21 days to raise any objections.

The managing agent must send any objections to Lloyd's together with its written response to those objections. Before granting consent, Lloyd's will give careful consideration to the objections together with the managing agent's responses and will determine whether it is of the view that it is appropriate in all the circumstances to approve the application.

Where a managed syndicate is only supported by one or more aligned members, the managing agent will still be required to submit an application to Lloyd's for consent to amend the managing agent's agreement but, ordinarily, Lloyd's would grant consent provided that the directors of the aligned member(s) have confirmed in writing that they approve the proposals.

Where a managing agent has obtained Lloyd's approval to vary profit commission terms in the managing agent's agreement, the agent must lodge details with David Aris in the Members Services Unit on 0207 327 2486 or email david.aris@lloyds.com for disclosure in the register of charges.

As stated above, Lloyd's considers the general principle that managing agents should treat all members of a syndicate year of account equitably to be important. Managing agents are therefore reminded that they should ensure that fees and profit commission terms are consistent across all members on each managed syndicate, unless they have Lloyd's approval to apply different terms.

Finally, any managing agents that are considering reducing profit commission charged to aligned members for periods after 31 March 2004 should consider with their advisers whether they would be affected by the UK-UK transfer pricing tax legislation. This may have the effect of imposing a tax charge on the managing agency by reference to the arm's length price for the services they perform. If you have queries on the tax treatments please contact Juliet Phillips in Taxation Department on 0207 327 5839 or email juliet.phillips@lloyds.com.