LLOYD'S

MARKET BULLETIN

REF: Y3991

Title	Revisions to financial guarantee insurance requirements in respect of Contract Frustration and Trade Credit exempted classes.
Purpose	Market Bulletin Y3226 of 23 December 2003 provided Lloyd's definition of Financial Guarantee ("FG") insurance and details of exempted classes that Lloyd's syndicates are permitted to underwrite. Various prior market bulletins set out the requirements that Lloyd's syndicates should observe when underwriting the exempted classes. The purpose of this bulletin is to provide updated definitions of those classes of FG insurance which Lloyd's syndicates may underwrite ("the Exempted Classes") and to provide updated details of Lloyd's requirements in respect of particular Exempted Classes.
Type	Event
From	Rolf Tolle, Director of Franchise Performance
Date	30 March 2007
Deadline	See 1.2 below.
Related links	Market Bulletin Y3226, 23 December 2003 Market Bulletin Y2642, 31 October 2001 Market Bulletin Y2406, 7 November 2000 Market Bulletin 060/98, 26 June 1998

1. Application of this Bulletin

1.1 Contracts of FG insurance after the date of this bulletin which do not fall within the definitions provided in this Bulletin (and, where applicable, do not meet the particular requirements detailed in Annexe 2 to this bulletin) should not be entered into without the prior written approval of the Lloyd's Franchise Performance Directorate.

1.2 This bulletin applies with immediate effect but please note that it does not apply retrospectively. However, in respect of those risks where specific approval has been granted and to which underwriters are contractually bound and which attach before 1 May 2007, such risks will not be subject to the requirements of this bulletin. Thereafter, all new business and renewals, both insurance and reinsurance, will be subject to this bulletin if attaching after the bulletin's effective date.

1.3 This Bulletin consists of three annexes and, in particular, supersedes Market Bulletin Y2406 dated 7 November 2000 on Contract Frustration.

2 Dispensations Made Prior to the Date of this Bulletin

2.1 Various dispensations from Lloyd's requirements have been provided in accordance with the provisions of Market Bulletin Y2406 of 7/11/2000. None of these dispensations are rescinded by this bulletin.

2.2 For every policy concerned, a copy of the relevant Lloyd's letter of dispensation, scratched by the Leading Lloyd's Underwriter, should be shown to following Lloyd's underwriters and included with the documentation submitted to XIS. XIS currently apply a check to ensure that this requirement has been met.

2.3 Dispensations which relate to any of the other requirements made under Market Bulletin Y2406 remain limited to those policies which were the subject of the Lloyd's letter relating to that dispensation.

3 It should be noted that it is proposed that the requirements of the Lloyd's Franchise Performance Directorate in respect of financial guarantee business, including the Lloyd's definition of financial guarantee, be reviewed with the aim of simplification. This somewhat complex bulletin, produced with considerable input from members of the LMA's Political Risk Business Panel, is being issued in the meantime in order to enable underwriters to address the issues raised by the implementation of the Basle 2 regulatory regime for banking institutions.

4 Many of the previous prescriptionary requirements have been eliminated but the principles contained within Annexe 3 should be adhered to.

Enquiries to this bulletin or to any other aspect of FG business at Lloyd's, exempted or otherwise should be directed in the first instance to Bill Rendall (bill.rendall2@lloyds.com or 020 7327 5810). Copies of the Lloyd's bulletins referred to can be obtained either from the hyperlinks shown above or from Bill Rendall.

This bulletin has been sent to all managing agents, active underwriters, members' agents, recognised auditors, market associations and Lloyd's brokers.

Rolf Tolle
Director of Franchise Performance

Annexe 1

Definitions of the Exempted Classes

Terms shown in italics are defined in Annexe 2 to this bulletin.

1 Contract Frustration (Risk Code “CF”)

1.1 Contract Frustration insurance (Risk Code "CF") indemnifies an insured for loss under:

(i) a specified contract for the sale, purchase, lease or delivery of goods, assets or services, or

(ii) an agreement which relates to the financing of such specified contract(s), or

(iii) an agreement concerning financing which is secured against assets, goods or services and/or payment for assets, goods or services due under such a specified contract, or where repayment is to be effected by the sale or receipts of such goods or services, or assets, royalties or other specified receivables.

1.2 due directly to one or more of the following perils:

(i) a *Political Force Majeure* event; or

(ii) an event resulting directly or indirectly from the actions, inactions and/or default, of a *Supra-National Authority*, or *Government Entity*, including the inability to make a currency conversion and/or exchange transfer. Such actions may also include default of a *Government Entity* which is guaranteeing the performance of either another *Government Entity* or of a *Commercial Organisation.*

It should be noted that;

1.3 *Lender’s Interest* risks can include elements of Contract Frustration perils as detailed in Annexe 2, paragraph 7.

1.4 Contract Frustration insurance may cover currency inconvertibility and/or exchange transfer risks only, including when there is no specified contract of sale, purchase, lease or delivery of goods, assets or services. Except where the risk is Trade Credit, any section of a policy that covers currency inconvertibility and/or exchange transfer risks shall be considered as Contract Frustration insurance.

1.5 Under no circumstances should Contract Frustration insurance cover risks relating to *Sovereign Lending.*

1.6 Under no circumstances should Contract Frustration policies insure against currency fluctuations and/or devaluation.

1.7 Contracts that are permissible within section 1.1 may also include *Bonds*, concession agreements, investment contracts and acquisition agreements. However, such contracts may, where appropriate, be insured under other risk codes subject to any requirements in relation to those risk codes.

2 <u>Trade Credit (Risk Code "CR")</u>

2.1 Trade Credit insurance indemnifies an insured for loss under:

i) a specified contract(s) for the sale, purchase, lease or delivery of assets, goods or services, or

ii) an agreement which relates to the financing of such specified contract(s), or

iii) an agreement concerning financing which is secured against assets, goods or services and/or payment for assets, goods or services due under such a specified contract, or where repayment is to be effected by the sale or receipts of such goods or services, or assets, royalties or other specified receivables;

due directly to the actions, inactions and/or default by a *Commercial Organisation*.

2.2 Trade Credit insurance does not include:

(i) Contracts made by the insured with private individuals (other than sole traders);

(ii) Mortgage Finance insurance (see section 4 below).

2.3 Under no circumstances should Trade Credit policies insure against currency fluctuations and/or devaluation

2.4 Contracts that are eligible for inclusion within this section 2 may include *Bonds,* concession agreements, investment contracts and acquisition agreements.

3 <u>Insureds acting in a lending capacity may also be indemnified under Contract Frustration or Trade Credit insurance where they are</u>:

3.1 providing *Project Related Financing* or

3.2 the beneficiary of a policy protecting against *Lender's Interest* risks

Underwriters must give proper consideration to the application of CF and CR risk codes and the appropriate apportionment of premium in respect of any Contract Frustration perils included in any Trade Credit Policy.

4 Mortgage Finance Insurance (Risk Code "FM")

Mortgage Finance Insurance indemnifies a bank or other lender who has provided a loan to a borrower only where the loan is used to purchase a commercial or residential property (which shall mean a building and not, for example, a ship or aircraft) and where this property is mortgaged to the bank or lender as security for the loan. Mortgage Finance Insurance responds if a shortfall remains between the amount of the loan and the proceeds realised from disposal of the mortgaged property following repossession.

5 Surety Bond Reinsurance (Risk Code "SB")

5.1 Surety Bond Reinsurance indemnifies a surety bond provider against the failure by the party (obligor) whose contractual obligation is the subject of the surety bond to execute a specified contractual obligation to the third party (obligee) identified on the surety bond.

5.2 Lloyd's underwriters are not permitted to provide surety bonds on a direct basis. Market Bulletin Y2642 of 31 October 2001 refers.

6 Salvage Guarantee Insurance

Collision, salvage and general average guarantees indemnify against the failure of a guarantor to perform its obligations under various forms of marine guarantees. Market Bulletin 060/98 of 26 June 1998 refers.

Annexe 2

Definitions of Italicised Terms used in Annexe 1

1. Political Force Majeure

Riots, strikes, civil commotions, malicious damage, sabotage, terrorism, war, invasion, acts of foreign enemies, hostile action by national or international armed forces (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power, or other similar events.

2. Supra-National Authority

A multi-national (also known as a "multilateral") institution (e.g. the United Nations, the International Monetary Fund or the European Union) which has a ruling body whose controlling interest is held by government ministers, or formally appointed representatives, of member states.

3. Government Entity

A "Government Entity" must conform to at least one of the following criteria:

(i) a Central Government or a Ministry, Department or Agency thereof (hereinafter referred to as "Government");
(ii) a Regional or Local Authority or a Department or Agency thereof (hereinafter referred to as "Local Authority");
(iii) a Nationalised Undertaking, including a Public Corporation or a State Trading Organisation or an entity in which the Government of the country(ies) concerned or Local Authority(ies) retain(s) a controlling interest or a majority shareholding; or
(iv) a central bank or other equivalent monetary authority.

In the event of a Government Entity obligor ceasing to conform to one of the above criteria during the currency of the Policy period, then underwriters may maintain coverage on original terms and conditions at their sole discretion until the expiry of the original risk.

4. Sovereign Lending

Any loan or other transaction or activity for the provision of finance and any guarantee or indemnity in respect of such transaction or of any other financial obligation into which a *Government Entity* enters other than for an identified trade or *Project Related Finance* or which is secured upon a commodity, asset, royalty or other specified receivable.

5. Project Related Finance

The provision of any loan (or other transaction or activity for the provision of finance or of any other financial obligation) for a specific project. On such policies, the insured must satisfy underwriters, prior to inception, of the purpose for which the funds advanced under the financing agreement are required, and that the financing agreement reflects this.

6. Commercial Organisation

Limited companies, public limited companies, partnerships, and sole traders, which may include banks or financial institutions, but none of the foregoing may include a Government Entity.

7. Lender's Interest

Lender's Interest insurance shall be limited to a Policy which indemnifies against default or non-(re)payment by a Commercial Organisation on a loan, whether or not there is a specified trade contract, where the default or non-(re)payment is directly caused by one or more of the following perils:

iv) an expropriatory act;

v) arbitration award default where the award is to remedy an insured expropriatory act or licence cancellation;

vi) a *Political Force Majeure* event;

vii) prevention of currency conversion and/or exchange transfer;

viii) embargo/licence cancellation:

ix) other Contract Frustration perils as may be agreed

However, Lender's Interest policies must not cover non-performance by the borrower or non-payment of the loan except where the non-performance or non-payment directly arises from the perils specified above.

Underwriters should give proper consideration to the risk coding of business written. In particular, currency inconvertibility/exchange transfer exposures should be coded “CF”. However, this shall not preclude the use of the applicable risk codes for the other perils mentioned above.

8. Bonds

Bonds shall be defined as on-demand bank guarantees or standby irrevocable letters of credit issued by banks in support of commercial obligations assumed by and among entities involved in the provision of goods or services.

Annexe 3

Principles for Particular Permitted Classes

1 Risks which fall within the scope of the Contract Frustration and Trade Credit classes (including *Lender's Interest* risks) were previously required to incorporate in the policy wording certain mandatory clauses in a prescribed format

With effect from the date of this Bulletin such clauses are no longer mandatory but the principles detailed in 2 i) to 2 iii) below should be observed. The QA tool checks will be amended to take account of these principles and XIS will be asked not to apply the current checks from the date of this bulletin.

2 i) Assignment of Policy

Underwriters subscribing to Contract Frustration and Trade Credit policies should ensure that the policies do not become a tradable commodity by containing a condition that only allows assignment of the policy in certain predefined circumstances or with their prior agreement. In particular they should ensure that where assignment of a policy does take place the obligations placed upon the original insured by the terms of the policy are transferred so that they become obligations of the assignee.

It is acceptable to allow for the proceeds of a policy to be paid to a third party provided that the obligations on the insured under the terms of the policy remain with the insured.

ii) Currency fluctuations and devaluations

Currency inconvertibility and exchange transfer embargo are permitted causes of loss under Contract Frustration and Trade credit policies but, as stipulated in paragraph 1.7 of Annexe 1, such policies are not designed or intended to be used for the purpose of currency speculation or trading.

Where underwriters consider it necessary, they should add conditional or exclusionary language to address any elements of currency fluctuation and/or devaluation that may be pertinent to an insured risk.

iii) Financial default and insolvency

Where financial default and insolvency is a covered cause of loss the appropriate risk code, CF or CR, should be used according to whether the obligor is considered to be public or private as detailed earlier in this bulletin.

Where underwriters consider it necessary, they should add conditional or exclusionary language to address or remove the risks of loss arising from or contributed to by any entities other than those whose financial default or insolvency it is intended to cover.

Iv) <u>Nuclear, biological, chemical etc:</u>

There is no longer any requirement for the incorporation of a “Five Major Powers War” exclusion clause such as that specified in Market Bulletin 2406 dated 7 November 2000 and neither is there a requirement for a nuclear, radioactive contamination (RACE) or similar exclusion clause but where a managing agent wishes to provide coverage in respect of nuclear, biological, chemical and similar perils it must be able to properly monitor and control the accumulations that could arise from, or be contributed to by, such perils and take account of them in the business planning process.