

MARKET BULLETIN

REF: Y4204

Title	LRO to amend Lloyd's Act 1982 – Market Reform Byelaw Consultation
Purpose	To seek feedback from interested parties
Type	Event
From	Sean McGovern, Director & General Counsel 0207 327 6142/ sean.mcgovern@lloyds.com
Date	11 November 2008
Deadline	12 December 2008

Purpose

In March 2008, HM Treasury published, by way of consultation, proposals to amend Lloyd's Act 1982 through a Legislative Reform Order ("LRO"). Six of the proposals related to improving Lloyd's governance arrangements to bring them more in line with modern practices in the wider corporate arena. The other two were market related namely repeal of section 8(3) Lloyd's Act 1982 which provides that, generally, syndicates may only accept business from a Lloyd's broker and repeal of the divestment provisions.

Lloyd's has already consulted on necessary amendments to its byelaws that would need to be made in order to implement the governance reforms if the proposed LRO is passed. In order to give proper effect to the market related reforms in the LRO, Lloyd's will also need to amend its intermediary byelaws. This bulletin therefore explains the market related reforms, sets out the amendments we would need to make if, as we anticipate, the LRO in its current draft is made by Parliament. The bulletin also seeks market feedback.

Background

The LRO proposals received the overwhelming support of Lloyd's members at an Extraordinary General Meeting held on 21 May 2008. HM Treasury's 12 week long public consultation process concluded on 30 May.

On 17 July, HM Treasury laid before Parliament a draft LRO to implement the eight proposals, along with an accompanying explanatory document which summarises the consultation responses the Treasury received and the proposals themselves (<http://www.hm-treasury.gov.uk/5673.htm>).

The proposed Order has now been considered by Committees of the Houses of Commons and Lords. The Committees have both reported that they are content with the proposed reforms being made by means of an LRO. The next stage will be for the proposed Order to be considered by both Houses of Parliament in accordance with the procedure recommended by the Government and as approved by the Parliamentary committees .

The market related reforms

Repeal of section 8(3)

The first market related reform is the proposal to repeal section 8(3) Lloyd's Act 1982. Section 8(3) provides that, generally, syndicates may only accept business from a Lloyd's broker (see <http://www.lloyds.com/NR/rdonlyres/1761C668-361B-4303-8FF0-3E2EF39B0CD5/0/March06ByelawLloydsAct1982.pdf>)

Lloyd's supports the Treasury's proposal to repeal section 8(3) because it is a statutory restriction that none of Lloyd's competitors face. Its inclusion in Lloyd's Act 26 years ago reflected the insurance and regulatory environment at that time. That environment has changed significantly since then, both commercially and from a regulatory standpoint (in particular, the FSA now regulates both managing agents and brokers) and will continue to change in the future.

On any basis, it is no longer appropriate for statute to determine the distribution arrangements at Lloyd's. Lloyd's is subject to the same competitive pressures as the rest of the global insurance industry and must have the flexibility to adapt in the future to ensure our continued success.

Lloyd's is of course concerned to ensure that any new brokers that wish to place business to a syndicate do not represent an additional prudential risk to the market. Accordingly, the proposed Order will give Lloyd's express powers to make byelaws to determine how managing agents deal with non-Lloyd's brokers.

In light of our discussions with the market, Lloyd's proposes to implement rules to ensure that managing agents apply the same prudential standards that are required of Lloyd's brokers to any non-Lloyd's brokers with whom they directly deal. This will create a level playing field. (For the avoidance of doubt the standards that we are consulting upon at this time will not apply to non-Lloyd's brokers that service companies or coverholders deal with. Instead they apply to the position where a syndicate, through a managing agent, directly deals with a non-Lloyd's broker).

It is proposed that the standards are those that were introduced in 2007 for Lloyd's brokers with the support of managing agents and the LMBC. This would mean that a managing agent may only do business directly with a broker that:

- a) is properly regulated under the EU Insurance Mediation Directive (or equivalent standards outside of the EU) and can thereby demonstrate that it is competent, of good repute and has adequate financial capacity;

- b) is able and willing to enter into a terms of business agreement (“TOBA”) with each managing agent with whom it intends to place business;
- c) has adequate, suitable and compatible systems, protocols and arrangements for the conduct of business in the London insurance market;
- d) has suitable procedures in place to ensure that insurance monies are properly safeguarded; and
- e) has adequate professional indemnity insurance of £3 million or four times the annual net retained brokerage (subject to certain caps).

By ensuring that all brokers that syndicates deal with meet these standards, whether or not they are a registered “Lloyd’s broker”, Lloyd’s believes that the prudential risks to the market will be properly managed.

Managing agents will be expected to be able to demonstrate that they have suitable arrangements in place to satisfy themselves that any non-Lloyd’s broker with whom they deal meets these minimum standards. Where a managing agent is unable to demonstrate to Lloyd’s satisfaction that those arrangements are suitable then Lloyd’s would have the ability to audit those arrangements.

The classification of “Lloyd’s broker” will, of course, remain and brokers who wish to continue in that capacity will be able to do so and new brokers will continue to be able to apply to become “Lloyd’s brokers”. This will continue to recognise the very important role that Lloyd’s brokers have to play at Lloyd’s and the benefits that high quality intermediation brings to the market. Lloyd’s will continue working closely with the Lloyd’s broking community to develop and build upon the relationships and understand how Lloyd’s and brokers can work more closely together.

Repeal of sections 10-12 – the “divestment provisions”

The second market related reform is the proposal to repeal sections 10 to 12 of Lloyd’s Act 1982 (the “divestment provisions”). These highly complex and unwieldy provisions prohibit most (but not all) associations between Lloyd’s brokers and managing agents.

Lloyd’s supports the Treasury’s proposal to repeal the divestment provisions because, again, they are a statutory restriction that none of our competitors face. Furthermore, and in contrast to the situation in 1982 when the divestment provisions were enacted, there is now external regulation of conflicts of interest through the FSA’s rules for brokers and managing agents (in particular, the FSA’s Principles for Business and INSPRU 8.2).

However, because of Lloyd’s unique structure, which includes unaligned members, the Treasury considers that the FSA’s rules for the handling of conflicts should be supplemented by Lloyd’s by implementing, under byelaw, additional disclosure requirements. Accordingly, Lloyd’s proposes to require managing agents to:

- (a) disclose in each syndicate business plan whether it is proposing to transact business with an intermediary that is a member of the managing agent’s own corporate group;

- (b) disclose in each syndicate business plan all insurance transactions that it entered into the preceding year through a related party; and
- (c) give an annual statement confirming that it has systems and controls in place for managing such conflicts of interest fairly in accordance with the applicable Lloyd's and FSA requirements.

In addition:

- (i) Lloyd's will issue a new "franchise standard" to require managing agents to ensure that they have systems and controls in place for managing conflicts of interest with related party intermediaries fairly; and
- (ii) the new Lloyd's Accounting Regulations introduced in July 2008 for Lloyd's syndicates to implement the Audit Directive (2006/43/EC) and the Reporting Directive (2006/46/EC) include enhanced related party transaction disclosure requirements.

We believe that these enhanced disclosure requirements will allow members and Lloyd's to monitor possible conflicts of interest and complement the FSA's role in this area, while allowing sufficient flexibility to adapt to changes in the regulatory and commercial environment.

Managing agents will be provided with a pro-forma SBF addendum in the New Year for making any necessary disclosures under the new requirements.

Timing / coming into force

It is proposed that the proposals set out in this bulletin shall come into force in January 2009.

Until then the current rules relating to acceptance of business by syndicates and the divestment provisions shall continue to apply.

Consultation responses

All of the proposed Lloyd's requirements referred to in this bulletin are set out in Annex A. Lloyd's believes that these proposed requirements constitute a fair, proportionate and appropriate set of requirements. In developing these requirements we have already had the benefit of discussing these matters with a number of interested parties including the LMA and LMBC.

We welcome feedback and comments on the proposed byelaw requirements from any interested party including managing agents, existing Lloyd's brokers and member representative bodies. Please send any comments to -

Caroline Strawford, (caroline.strawford@lloyds.com), Lloyd's Legal by no later than Friday, 12 December 2008.

Annex A

Byelaw amendments

Amendments to the Underwriting Byelaw

1. The Underwriting Byelaw is amended as follows –
 - (a) by deleting paragraph 14 and substituting therefore the following new paragraphs –

“14A. Each year a *managing agent* shall prepare and submit to the *Franchise Board* a *business plan* relating to each *syndicate* managed (or to be managed) by it (other than a *run-off syndicate*) setting out –

- (a) the parameters within which the *managing agent* will carry out *underwriting* on behalf of each *syndicate*; and
- (b) information relating to any association or *underwriting* transaction which may give rise to a conflict of interest including a transaction where a counterparty or an intermediary is a member of the *managing agent’s own group* and a statement confirming that it has systems and controls in place for managing any such conflicts of interest fairly in accordance with applicable Lloyd’s and FSA requirements.”

“14B The *Franchise Board* may prescribe requirements for *business plans* which may include –

- (a) the period or periods to which each plan is to relate;
- (b) the format and content of each plan;
- (c) the methods and assumptions to be used in the preparation of each plan; and
- (d) the date or dates on which each plan is to be submitted to the *Franchise Board*. ”

[note – highlighted text above is the new substantive text compared to existing paragraph 14]

- (b) by inserting new paragraph 23A –

“23A Every *members’ agent* must ensure that information provided pursuant to paragraph 14A(b) above or any agreed amendment to a *business plan* which

may give rise to a conflict of interest is drawn to the attention of *members* of the *syndicate* in question (and prospective *members* of the *syndicate*) for whom the *members' agent* acts.”

(c) by deleting paragraph 27 and substituting therefore the following new paragraph –

“27. A *managing agent* may only accept business on behalf the *members* of a *syndicate* which it manages from –

- (a) a *Lloyd's broker* provided that prior to accepting business the *managing agent* has entered into a *terms of business agreement* with the *Lloyd's broker*;
- (b) the insured or reinsured or, in the case of a *syndicate*, another *managing agent*;
- (c) an *approved coverholder* in accordance with the terms of a *registered binding authority*;
- (d) a *restricted coverholder* in accordance with the terms of a *restricted binding authority*;
- (e) a *service company coverholder* in accordance with the terms of a *binding authority* that is a *service company agreement*;
- (f) Lloyd's Reinsurance Company (China) Limited, or in respect of business constituting “Singapore policies” or “offshore policies” (as respectively defined in the Insurance Act (Cap 142) of the Republic of Singapore) from or through a *person* who is not a *Lloyd's broker* where that *person* has obtained the prior consent of the *Franchise Board*; and
- (g) such other *person* where, prior to accepting business, the *managing agent* has -
 - (i) satisfied itself that the *person* meets such criteria as the *Franchise Board* may from time to time prescribe; and
 - (ii) entered into a *terms of business agreement* with that *person*.

(d) by deleting paragraphs 28, 29 and 66(a);

(e) by deleting in paragraph 68 the words “other than paragraph 66(a)”.

Amendments to the Intermediaries Byelaw

2. The Intermediaries Byelaw is amended by deleting paragraphs 47, 52, 56, 66 and 67.

[note – paragraph 47, is being superceded by new paragraph 27(g)(ii) in the Underwriting Byelaw (see above). Paragraphs 52, 56, 66 and 67 are being deleted as they relate to the previous divestment provisions.]

Amendments to the Definitions Byelaw

3. By inserting the following new definition -

“terms of business agreement” means an agreement between a *managing agent* and a *person* recording the general terms and conditions on which business will be conducted between them and which includes such matters as the *Franchise Board* may prescribe that are to be recorded in such an agreement.”

Amendments to the Central Accounting Byelaw

4. The Central Accounting Byelaw is amended as follows –

- (a). By deleting sub-paragraph 2(4)(f) and replacing with -

“any person pursuant to paragraph 27 of the Underwriting Byelaw from whom a *managing agent* may accept business on behalf the *members* of a *syndicate* which it manages.”

- (b) By deleting sub-paragraph 2(4)(g).

Underwriting Requirements

Underwriting Requirements – Chapter 1 amendments

Requirements made under paragraph 34 of the Underwriting Byelaw are amended as follows:

- (a) By deleting paragraph 7(b)

Amendment to requirements made under paragraphs 14A and B of the Underwriting Byelaw (amendments as highlighted to SBF requirements)

“21.5 Related Parties Transactions

21.5.1 Managing Agents are required to include in their syndicate business plans –

- (a) all related party insurance transactions that it intends to enter into for the current and proposed years of account. Related party insurance transaction is one where the syndicate will either –

- insure, reinsure or place reinsurance with or through a related party; or
- insure, reinsure or place reinsurance with or through any person other than on an arms length basis on ordinary commercial terms.

“through” for these purposes means through any person acting as an insurance intermediary or broker.

- (b) a statement confirming that it has systems and controls in place for dealing with related parties in order to ensure any conflicts of interest are managed fairly in accordance with applicable Lloyd’s and FSA requirements (including applicable conflict management rules in Lloyd’s Franchise Standards and the FSA handbook; PRIN 2.1.1, INSPRU 8.2.6 and 8.2.7).

21.5.2 Managing Agents are required to include in their syndicate business plans all related party insurance transactions that it entered into in the preceding year through a related party or through any person other than on an arms length basis on ordinary commercial terms.

21.5.3 A related party for these purposes means –

- any company within the same group as the managing agent;
- any company within the same group as a corporate member of the syndicate which has a syndicate premium income of more than 10% of the syndicate allocated capacity;
- any company which has two or more directors in common with the managing agent.

21.5.4 Group has the meaning set out in section 421 of the Financial Services and Markets Act 2000.

21.5.5 Managing Agents may only underwrite on behalf of a syndicate in accordance with its agreed business plan. Accordingly, a Managing Agent which proposes to enter into a related party insurance transaction which is not referred to in the agreed business plan must apply to the Franchise Performance Directorate to add the transaction in question.”

Underwriting Requirements - Chapter 2 amendments

Requirements made under paragraphs 27(g) of the Underwriting Byelaw and 46 of the Intermediaries Byelaw

18. The criteria to be applied in respect of a *person* established in a member state of the European Union are that it –
- (a) is registered with a competent authority for the purposes of the European Parliament and Council Directive of 9 December 2002 on insurance mediation (No.2002/92/EC)(the “Directive”);
 - (b) is able and willing to enter into an agreement with each *managing agent* with whom it intends to place business recording the general terms and conditions on which business will be conducted between them;
 - (c) has adequate, suitable and compatible systems, protocols and arrangements for the conduct of business in the London insurance market;
 - (d) has suitable procedures in place to ensure that insurance monies (money relating to premiums, return premiums and claims) are properly safeguarded;
 - (e) has adequate professional indemnity insurance; and
 - (f) can demonstrate its ability to comply with any other criteria that the *Franchise Board* may from time to time prescribe,

and regard shall be had to any guidance the *Franchise Board* may issue in respect of the application of the above criteria. (See Section 3 of the “*Guide for Applicants*” at www.lloyds.com/Lloyds_Market/Market_participants/Brokers/Broker_Registration)

19. The criteria to be applied in respect of a *person* not established in a member state of the European Union are that it –
- (a) either –
 - (i) is registered or approved by a regulator or other statutory body that requires the intermediary or broker to meet professional requirements in relation to its competence, good repute and financial capacity equivalent to those provided for in the Directive; or
 - (ii) can demonstrate that it meets professional requirements in relation to its competence, good repute and financial capacity equivalent to those provided for in the Directive;
 - (b) satisfies the criteria at paragraph 18(b) to (f) above; and
 - (c) can demonstrate that it is capable and suitable to transact business having regard to such following criteria and any other relevant matter –
 - (i) whether the *person* possesses appropriate knowledge and ability to conduct *insurance business* in the London insurance market;
 - (ii) whether the *person* and its directors, partners, employees and controllers are of good repute;
 - (iii) the adequacy of the capital and financial resources of the *person*;
 - (iv) whether the *person* complies with all laws, rules and fiscal requirements applicable to it as an insurance intermediary wherever it is established and wherever it conducts or will conduct business.

Requirements made under paragraph 46 of the Intermediaries Byelaw (registration of Lloyd's brokers)

- 20 In determining whether an applicant should be registered as a *Lloyd's broker* the *Franchise Board* shall have regard to the criteria at paragraphs [] above of these requirements save that the *Franchise Board* may, where it considers it appropriate, disapply , amend or add to these criteria as it considers appropriate.

[note – the above paragraphs 18-20 are to replace existing paragraphs 18 and 19 of the Underwriting Requirements- Chapter 2]

Franchise Standards

To include the new highlighted text below in the “effective operational process” standards-

The managing agent has effective operational and business processes which enable it to meet its strategic aims.

Standards

The managing agent can demonstrate that –

.....

- it has systems and controls in place for managing any conflicts of interest with related party intermediaries or broker fairly¹.

¹ See also, the FSA’s Handbook, Principles for Business (PRIN 2.1.1) <http://fsahandbook.info/FSA/html/handbook/PRIN/2/1> and Prudential Sourcebook for Insurers (INSPRU 8.2.6 and 8.2.7) <http://fsahandbook.info/FSA/html/handbook/INSPRU/8/2>