

FROM: General Manager, Authorisations, Regulatory Division
LOCATION: 58/NC1
EXTENSION: 5092
DATE: 18 November 1999
REFERENCE: 090/ 99
SUBJECT: **THE AGENCY OBLIGATIONS OF LLOYD'S
MANAGING AGENTS**

SUBJECT AREA: Agency Principles
ATTACHMENT(S): Circumstances specified by the Council under paragraph 3(4) of the Agency Agreements Byelaw (No.8 of 1988) and Guidance Note
ACTION POINTS: **For information**
DEADLINE: **With effect from 1 January 2000**

Background

Earlier regulatory bulletins have noted the difficulties that have arisen from the application of managing agents' general agency law duties in circumstances where a potential conflict of interest existed, either because an agent managed syndicates comprising both aligned and unaligned members, or because the agent was part of a group which contained an insurance company.

The bulletins also noted that the standard managing agent's agreement did not contain a mechanism whereby such conflicts could be resolved. Accordingly, the only options that were available to a managing agent to obtain legal certainty were either a) to obtain the consent of every member of every syndicate that the agent managed and with whom its interests might conflict or b) to obtain the approval of the court. Neither option was attractive or presented a sensible way in which to organise underwriting business at Lloyd's.

Accordingly, earlier this year the Council made the Agency Agreements (Amendment No.20) Byelaw. Part A of the Byelaw amends the standard managing agent's agreement with effect from the 2000 year of account. The amendment provides that no transaction, arrangement, relationship, act or event which would or might otherwise be regarded as constituting or giving rise to a contravention of an agent's

fiduciary obligations shall be regarded as constituting such a contravention if the transaction, arrangement, relationship, act or event occurs in circumstances specified by the Council and in compliance with conditions and requirements specified by the Council.

The circumstances in which the modification to the managing agent's agreement may be applied and the conditions and requirements to be complied with by the managing agent in those circumstances, were subject to consultation.

The Lloyd's Regulatory Board (LRB) concluded that, overall, the responses to the consultation exercise showed a favourable recognition that Lloyd's was seeking to develop a practical mechanism for the resolution of conflicts of interest, whereby members' rights and interests in the ongoing business of a syndicate would be properly protected, whilst providing agents with regulatory and legal confidence to proceed with appropriate business opportunities as they arise.

The LRB therefore recommended the Circumstances to the Council save for the so-called "remoteness" and "de minimis" conditions. A very large proportion of the responses to the consultation exercise had related to those conditions and the LRB concluded that the complexity of the additional provisions that would have been required to ensure that the conditions operated in a fair manner would have made them too cumbersome to be usefully applied. The LUAA's Managing Agents Committee subsequently endorsed that decision.

On the recommendation of the LRB, the Council specified the Circumstances in the form attached at Appendix 1.

The Circumstances

The circumstances in which the modification to the managing agent's agreement may be applied are as follows:

- (i) the acquisition, development or acceptance of underwriting business or a source of such business by a managing agent or a related insurance company other than for the benefit of the underwriting members of a syndicate managed by that agent; and
- (ii) the transfer or redirection of underwriting business previously accepted by the underwriting members of a syndicate, or a source of such business, to the underwriting members of another syndicate under the management of the same managing agent or to a related insurance company.

The Circumstances have been sufficiently widely drawn so as to include the acquisition or the development by a managing agent of a service company where the acquisition or development might operate in contravention of an agent's duties.

It is important to recognise that the Circumstances need only be applied in situations where the proposed acquisition or transfer of business might be regarded as constituting or giving rise to a contravention of the agent's duties.

Nothing within the Circumstances should be construed as prohibiting an agent from seeking to obtain the approval of the court or of all of its members to a proposed acquisition or transfer of business. However, it is thought that the application of the Circumstances will provide a much more effective and practical mechanism.

In summary, the Circumstances require managing agents to give full and fair disclosure to the members of the syndicate in question the terms of the proposed acquisition or transfer and the nature of the managing agent's conflict of interest or duty. The managing agent must also invite any members of the syndicate who object to the acquisition or transfer to notify the agent within a specified period. The managing agent may, during that period, seek to address any concerns that members may raise, but in the event that 10% by value of the unaligned members object to the proposal the agent is obliged, if it wishes to proceed, to conduct a ballot of the unaligned members of the syndicate to approve the proposal. Approval may be given by a majority by value of the unaligned members voting in the ballot.

Procedural arrangements

The Circumstances set out the relevant conditions and requirements with which a managing agent must comply. Further information on the application of the Circumstances is set out in the Guidance Note attached at Appendix 2. Managing agents should have careful regard to the Guidance Note.

Further information

If you have any questions with regard to the Circumstances or the Guidance Note please do not hesitate to contact Simon Hardy (ext. 5622) in the Authorisation Department or Amanda Baxendale (ext. 5696) in the Legal Services Department.

This bulletin has been sent to all underwriting agents, market associations and for information to recognised accountants.

Peter Neville
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**Circumstances Specified by the
Council under Paragraph 3(4) of the
Agency Agreements Byelaw (No.8 of 1988)**

Paragraph 3(4) of the Agency Agreements Byelaw (No. 8 of 1988) provides that the Council may specify circumstances in which any transaction, arrangement, relationship, act or event (whether or not directly involving the managing agent in question) which would or might otherwise be regarded as constituting or giving rise to a contravention of any obligation of a managing agent under paragraph (b) or (d) of clause 4.2 of the Managing Agent's Agreement or under any corresponding obligation implied by law in relation to conflicts of duty or interest, or as requiring a managing agent to account to a member of the Society for any gain or profit such as is referred to in paragraph (c) of that clause shall not be regarded as constituting such a contravention or as giving rise to any such obligation to account.

1. Specified circumstances

The Council has specified the following circumstances under paragraph 3(4) of the Agency Agreements Byelaw (No.8 of 1988):

- (a) The acquisition, development or acceptance of underwriting business (or source of such business) by a Related Person other than for the benefit of the underwriting members of a syndicate managed by the managing agent in question (the "Syndicate") where the conditions specified in paragraph 2 or the conditions specified in paragraph 3 have been satisfied and any supplementary requirements made under paragraph 5 have been complied with; and
- (b) The transfer or redirection of underwriting business (or source of such business) previously accepted by the underwriting members of a syndicate managed by the managing agent in question (the "Syndicate") to the underwriting members of another syndicate under the management of the same managing agent or to a Related Person where the conditions specified in paragraph 2 or the conditions specified in paragraph 3 have been satisfied and any supplementary requirements made under paragraph 5 have been complied with.

2. Disclosure and requisition

The conditions specified in this paragraph are as follows:

- (a) the managing agent has fully and fairly disclosed to the members of the Syndicate:
 - (i) the terms of the Proposal; and

- (ii) the nature of any conflict of duty or interest or potential conflict of duty or interest of the managing agent with regard to the Proposal; and
- (b) the managing agent has invited any member of the Syndicate who objects to the Proposal to notify the managing agent of his objection by a specified date not less than 21 days after the date of the disclosure referred to in sub-paragraph (a) and having attached to or enclosed with that disclosure a pre-paid notice of objection which may be used for that purpose;
- (c) the managing agent and its auditors certify to the Council after the period for objections in sub-paragraph (b) has expired either that no objections were received from members or that objections were received from members whose aggregate member's syndicate premium income limits for the syndicate for the current year of account are less than 10% of the aggregate of the member's syndicate premium limits for the syndicate for the current year of account of the members who are not Related Persons; and
- (d) the Council has confirmed to the managing agent that it does not consider that the Proposal should be subject to a ballot in accordance with paragraph 3(b) or the condition specified in paragraph 3(b) is satisfied.

3. Ballot

The conditions specified in this paragraph are as follows:

- (a) the managing agent has fully and fairly disclosed to the members of the Syndicate:
 - (i) the terms of the Proposal; and
 - (ii) the nature of any conflict of duty or interest or potential conflict of duty or interest of the managing agent with regard to the Proposal; and
- (b) the managing agent has conducted a ballot of the members of the Syndicate in question no earlier than 21 days and no later than 60 days from the date of disclosure referred to in sub-paragraph (a) or in paragraph 2(a) and the managing agent and its auditors certify to the Council that a resolution to approve the Proposal has been approved in the ballot by a majority by Value of the members of the syndicate who have voted in the ballot and who are not Related Persons.

4. Withdrawal of objection

For the purposes of sub-paragraphs 2(c) and 3(b) any objection which has been withdrawn by the member before the managing agent and its auditor make the certification referred to in those sub-paragraphs shall be disregarded.

5. Supplementary requirements

The Council may make supplementary requirements in respect of any matter to be undertaken in accordance with the above conditions.

6. Interpretation

For the purposes of these circumstances the following expressions shall have the following meanings:

- (a) “Proposal” means –
 - (i) in relation to the circumstance referred in paragraph 1(a), the proposed acquisition, development or acceptance of underwriting business (or source of such business) in question;
 - (ii) in relation to the circumstance referred to in paragraph 1(b), the proposed transfer or redirection of underwriting business (or source of such business) in question.
- (b) “Related Person” means in relation to a managing agent, a person who is related to that managing agent in any manner other than by merely participating in the underwriting business of a syndicate managed by that managing agent (but including without limitation through the possession by either of them of an interest in the other or by a third party of interests in both, or through the possession or common directors or employees) which would or might indicate that interests of that person are to be taken as being also interests of that managing agent or that that managing agent is to be taken to be interested in any matter in which that person is interested; and
- (c) “Value” in relation to any ballot, shall be determined by reference to the respective members’ syndicate premium limits of the members of the relevant syndicate for the year of account corresponding to the year in which the ballot is held.

Guidance Note

Circumstances Specified By the Council under Paragraph 3(4) of the Agency Agreements Byelaw (No.8 of 1999)

Application of this note

Managing agents and members should have regard to the guidance set out below when acting in accordance with the circumstances and the conditions specified by the Council under paragraph 3(4) of the Agency Agreements Byelaw. Managing agents should discuss any Proposal with the Authorisation Department of the Regulatory Division at the earliest opportunity.

General

It is incumbent upon both managing agents and members to proceed under the Circumstances in a fair, reasonable and constructive way.

Managing agents should be able to demonstrate to members and to Lloyd's that they have taken steps to comply with the spirit and the intention of this guidance note.

Members and Members' agents

Members, with the assistance of their members' agents, should promptly and diligently consider all documents forwarded to them by managing agents and members should respond in a considered and reasonable manner conducive to the ongoing relationship with their managing agents.

Disclosure – general

Any disclosure given by a managing agent must provide members¹ with all of the information that would materially assist an ordinary member to make an informed assessment of the matter in question. In particular:

- the information should be presented in a clear, balanced and straightforward manner;
- the information should be presented as succinctly as possible;
- key information should receive greater prominence; and
- technical terms should be avoided or clearly explained.

Disclosure - the Proposal

In giving disclosure of the terms of a Proposal, the following information should be provided in respect of the underwriting business in question:

- a general description of the underwriting business;
- an explanation of whether the underwriting business differs in any material way from the underwriting business of the Syndicate; and
- the amount of premium income and profit derived or anticipated to be derived from the business over a representative period.

¹ In this note, members means members of the syndicate who are not Related Persons.

The disclosure should also include:

- a summary of the business case underlying the Proposal; and
- the terms of any compensation (financial or otherwise) to be offered to members of the Syndicate. Any offer of compensation must be made to all members of the Syndicate.

Disclosure – the conflict

Managing agents must fully describe the nature of the conflict or potential conflict of duty or interest and explain why the interests of any Related Person are or could be taken as being also interests of the managing agent. The description should include information on any additional benefits that will accrue to any Related Party and any loss that will accrue to members under the Proposal.

Disclosure - timing

Managing agents must carefully consider the appropriate timing of any disclosure. Disclosure should generally be made as soon as the managing agent has formed a firm intention to proceed with the Proposal. However, managing agents must consider whether there are any specific matters such that the timing of the disclosure might unfairly prejudice the rights of members and whether, as a consequence, disclosure should be deferred. Managing agents must also have regard to their other legal obligations, for example with regard to insider dealing.

Related Person

The definition of a Related Person is widely drawn by reference to the identity of interests between that person and the managing agent in question. The burden of determining who is and who is not a Related Person is on the managing agent. Managing agents should record in each case how the determination was made.

In determining whether a managing agent is able to certify the matters set out in paragraphs 2(c) and 3(b) of the circumstances the definition of a Related Person:

- excludes any member of the Syndicate who is related to the managing agent merely by virtue of his participation in the underwriting business of the Syndicate;
- includes any member of the Syndicate who is a director or an employee of the managing agent.

Ballot – general

Managing agents must take all reasonable steps to conduct ballots in a fair manner, and in particular, the meaning of any resolution must be clear and present the issue on which the vote will be taken in a balanced way.

Failure to properly comply with conditions and requirements

Managing agents should note that failure to properly comply with the conditions and requirements set out in the circumstances may invalidate any regulatory or legal protection conferred by virtue of paragraph 3(4) of the Agency Agreements Byelaw (No.8 of 1988).