CODE FOR UNDERWRITING AGENTS:
SYNDICATE EXPENSES

This code was issued in a regulatory bulletin 069/00 dated 12 September 2000

Explanatory Note

This code has been made under the Core Principles Byelaw in relation to core principles 1, 4, 6 & 7. It is intended to assist managing agents in meeting the obligations imposed upon them by the Agency Agreements Byelaw (No 8 of 1988) and the Syndicate Accounting Byelaw (No. 18 of 1994) (SAB) as regards the charging of necessary and reasonable expenses and outgoings made or incurred in connection with the underwriting business of the managed syndicates and which are for the benefit of members.

In addition, it addresses the need for a managing agent to have and comply with a clearly defined policy statement regarding the charging of expenses to any syndicate that it manages, as required under paragraph 6 of the SAB. This statement, which must be signed annually by the managing agent, shall state that only expenses attributable to the underwriting business of the managed syndicates and which are for the benefit of the members are passed on to members through the books and records of the syndicate. It shall also undertake that where expenses relate to more than one year of account, equity between groups of members participating on these years of account will be preserved.

Furthermore, where expenses relate to both the operations of the managing agent and the syndicate, the statement shall specify how such expenses will be attributed as between the parties.

Application

This Code applies to all managing agents except in the following circumstances:

- where the members of the syndicate are wholly aligned with the managing agent; and
- where all of the members of the syndicate have agreed with the managing agent to disapply the code. In this case, disclosure should be made in the annual syndicate report and accounts that the members and the managing agent have so agreed.

Best Practice

The Code seeks to promote best practice. It should not, however, be taken to be exhaustive. Underwriting agents will be expected to demonstrate that they fulfil their responsibilities either by adhering to the Code or by other equivalent procedures.

Breaches

This code has been made under the Core Principles Byelaw, and in particular core principles 1, 4, 6 and 7. A failure on the part of any managing agent to observe any of the provisions herein could result in disciplinary proceedings being brought.

Nature of Syndicate Expenses

In order for an expense to be charged to the syndicate, the managing agent must ensure that the nature and quantum are both necessary and reasonable in relation to each member on a particular year of account, having regard to the circumstances of the syndicate. The expense must be attributable to all members participating on the year of account (unless separate funds exist) and should not disadvantage one group over another. Expenses which are not attributable to all members of the syndicate or of a separate fund should not be treated as syndicate expenses, but should be charged to members on an individual basis via the personal account.

Annex 1 details those expenses which, for the purposes of this Code, are considered necessary and reasonable. They have been listed under the expense category considered most appropriate for the expense in question.

Expenses which cannot be charged to the syndicate are those relating to the central costs of the managing agent and costs which do not relate directly to the affairs of the syndicate; examples are shown in Annex 2.

Annexes 1 and 2 are not intended to be exhaustive, but give indications of acceptable/unacceptable expenses. Where there may be some doubt as to the acceptability of an expense, the managing agent should allocate to the syndicate only those expenses which are necessary and reasonable for the performance of the underwriting and are for the benefit of members. Lloyd's will exercise supervisory control in making this judgement and if in doubt the agent should contact Lloyd's for regulatory guidance.

Equity Between Members

Having determined whether an expense is both necessary and reasonable to be charged to the syndicate the managing agent must consider whether the expense relates to more than one year of account. If so, consideration should be given to the basis of apportioning the expense between those years.

The managing agent should determine the basis to apply (which may not necessarily be the same in respect of all expenses incurred in any year, although it should be the same as regards expenses of a similar nature) bearing in mind, in particular, the need to ensure equity between different groups of members and the need to be consistent from year to year. The managing agent should pay particular regard to situations where the capacity and/or the business of the syndicate change from year to year in the event that this requires the allocation of expenses to be amended so as to preserve equity.

In addition, managing agents should allocate "start up" costs of a new syndicate so as to ensure that the first year of account of a new syndicate does not bear an inequitable proportion of those costs. Similarly, when a syndicate goes into run-off the managing agent should ensure that equity is maintained between members where there is more than one underwriting year involved. The apportionment and allocation must be capable of objective justification and managing agents should maintain full documentation regarding syndicate expenses for run-off years of account.

Shared Expenses

There may be circumstances where the distinction between a syndicate expense and an expense which should be borne by the managing agent becomes blurred, notably where an expense relates partly to the syndicate and partly to the managing agent. A further difficulty arises where expenses may be attributable to more than one syndicate.

The managing agent should ensure that the part of the expense relating to the syndicate(s) is both necessary and reasonable. The managing agent should then determine the basis on which the expense is charged to the syndicate(s) and where necessary as between groups of members of the syndicate(s). The basis adopted should be applied consistently from year to year and should be appropriate, taking into account the nature of the expense and disclosed in accordance with paragraph 14 of schedule 4 of the SAB.

It may not be appropriate to apportion all expenses, regardless of their nature, on the same basis. For example, where office space is shared between the managing agent and a group of syndicates, it would be most appropriate for allocation of the costs of accommodation to be made by reference to the proportion of total square footage of office space utilised by the managing agent and each syndicate respectively. Employment costs which relate to work performed for both the syndicate(s) and the agent should also be allocated according to the respective amounts attributable to each entity – for example, the employment costs of the underwriter should be allocated by reference to the proportion of time spent on agency affairs and underwriting respectively.

Managing agents should ensure that their accounting records and systems of control are adequate to facilitate identification of the expenses which should be charged to the syndicate and to distinguish them from those expenses which relate to the agency function.

Potentially Contentious Areas

Employment Costs

There are a number of aspects of concern relating to the broad question of employment costs and these are considered further below.

Contracts of Employment

In order to attract individuals of high calibre to a syndicate, it may be necessary to provide substantial remuneration 'packages' to underwriters, often subject to fixed period contracts of employment. Most members would accept this as being in their interest, except where such remuneration packages and contract terms appear to be better than what might otherwise be dictated by market forces. Managing agents must, therefore, give careful thought to those costs relating to the underwriter which might reasonably and justifiably be charged to the syndicate. Furthermore, the managing agent should disclose the details of the employment contract given to a new underwriter to members' agents and direct members in the annual syndicate report and accounts. In addition, if the employment terms of any underwriters that are currently employed by the managing agency are materially changed, the details of the new terms should be disclosed to members' agents and direct members in the annual syndicate report and accounts.

Termination Payments

Where it is necessary to terminate the contract of underwriting or agency staff before the expiry of that contract, the costs of doing so, strictly in accordance with the contract terms, may be charged to the syndicate as expenses, provided that the costs do not equate to more than twelve months salary and the allocation of that cost is undertaken in line with the agent's policy on the charging of syndicate expenses.

In circumstances where there is no contract provision relating to termination payments, it is arguable that, in accordance with the agency agreements, it is only permissible to charge the costs of redundancy to a syndicate to the extent that they do not exceed the statutory minimum sums payable to former employees. Where the managing agent has a policy applicable to both underwriting and agency staff to provide sums in excess of this, however, it may nevertheless be acceptable to charge the appropriate excess to the syndicate, provided always that such sums are not excessive of themselves, they are reasonable and provided that they do not equate to more than twelve months salary. This approach may be of particular relevance where there have been redundancies throughout the organisation on a large scale, since in such a case, the managing agent will also have borne its share of the burden of redundancy costs.

Pension Costs

Pension costs are a key part of an individual's overall remuneration package and may represent a significant proportion of an employer's payroll costs. To the extent that an individual's remuneration is charged to a syndicate, it is accepted that this remuneration may include an element for pension costs. In determining the overall cost of the pension (and then subsequently, the amount to be charged to the syndicate), the managing agent should have regard to the prevailing guidance from the accounting profession. In particular, the implications of pension surpluses or deficiencies need to be considered, bearing in mind the extent to which the syndicate has funded the pension and the specific terms of the pension trust deed.

Fixed Assets

From the 1999 year of account, syndicates have been allowed to use syndicate trust fund monies to purchase certain classes of fixed asset if the Council so consents. There may, however, be alternative funding arrangements in place whereby the managing agent owns the fixed assets and seeks to recharge to the syndicate an element of the costs of owning/financing fixed assets. These are acceptable expenses to be charged to the syndicate but only to the extent that the syndicate derives direct benefit from the asset. In view of this an agent should not seek to recoup the total acquisition cost of the asset from the current year, as regard must be paid to equity between years of account.

The managing agent must have particular regard to the apportionment/allocation basis which should be fully documented and determined by reference to some justifiable and verifiable criteria. This is a very important area, as the costs may be significant to the overall level of expenses charged to the syndicate.

Offer Documents

The cost of compilation and production of offer documents and brochures or marketing documents to promote the sale of capacity should be borne by the principal beneficiaries. The cost may only be charged as a syndicate expense therefore when the members are the principal beneficiaries.

Disclosure by Managing Agents

In accordance with paragraph 6 of the SAB the managing agent is required to make full, fair and prior disclosure of the basis which is to be adopted in respect of expenses charged to the syndicate, in order to enable both prospective and existing members and members’ agents to understand the nature of the costs that the syndicate will bear. This statement of policy should be approved annually by the Board and signed by two directors of, or partners in the managing agent and should form part of the accounting records of the syndicate in accordance with Schedule 2 of the SAB. It should be specific as regards the expenses to be incurred and the basis upon which they are charged to the syndicate and allocated to a particular year of account.

Furthermore, the total cost of participating on the syndicate (i.e. syndicate expenses and the managing agent’s charges) should be transparent and capable of being assessed by members.

One Stop Fees

Some managing agents have decided to charge what is commonly known as an annual “one stop fee” rather than separately charging expenses to the syndicate and an annual agency fee. The one stop fee will therefore involve the managing agent estimating, prior to the inception of a year of account, the expenses it will bear relating to the syndicate and combining this with the expense items normally recovered by the annual agency fee, so as to arrive at one all encompassing charge.

It is recognised that managing agents enter into this fee charging structure in order to dispense with the need to have in place administrative procedures to monitor the ongoing allocation of actual expenses between the agency and the managed syndicates. In view of this, managing agents that charge a one stop fee are exempted from complying with this code of practice.

In certain circumstances such fees do not include all expenses anticipated to be incurred by the syndicate and if this is the case this should be disclosed in the annual policy statement, required to be produced under paragraph 6 of the SAB and in the syndicate list to be signed by members. Any expenses that are then to be charged separately to the syndicate will be subject to the requirements laid down in the Agency Agreements Byelaw, the SAB and the guidance contained in this Code.

ANNEX 1:
Examples of expenses considered acceptable

Salaries and related costs

- employment costs including salaries, benefits, pensions and other costs such as compensation for loss of office for staff involved in the underwriting and in running the business of the syndicate;
- profit and performance related remuneration payable to staff involved in underwriting and in running the business of the syndicate except to the extent that it is payable to:
  - i) the active underwriter;
  - ii) a director or partner or controller[1] of the managing agent of the syndicate or of any holding company, subsidiary or connected company of that managing agent.

Cost of accommodation

the cost of the accommodation for the underwriting and claims staff and those involved in running the business of the syndicate and any other occupancy costs, such as refurbishment, relating to the syndicate.

Interest payable and other charges

- in respect of syndicate premiums trust fund overdrafts, borrowings, or letters of credit or any other financing arrangements which have been arranged for the benefit of members of the syndicate.

Premium charge

- for repayment of the syndicated loan

Processing costs

- all Lloyd's charges relating to the operation of the syndicate (eg LPSO, Citibank Trust Fees) other than those required to be charged in members' personal expenses.

Overseas operating expenses

- Overseas levies arising from Lloyd's licensing status in those territories.

[1] For this purpose:

(i) controller has the meaning given in paragraph 1(f) of the Underwriting Agents Byelaw (No. 4 of 1984).

(ii) "subsidiary" and "holding company" have the meanings given to them by section 736 of the Companies Act 1985; and

(iii) "connected company" has the meaning given in paragraph 1(j) of the Underwriting Agents Byelaw (No 4 of 1984).

Recognised accountants fees

- In relation to work performed for and the audit of the annual report and syndicate MAPA accounts pursuant to paragraph 14 of the Syndicate Accounting Byelaw, compliance reporting of a general pro-forma nature including compliance with Lloyd's sound and prudent management criteria and any other work undertaken to comply with Lloyd's requirements;

Cost of professional advisers in connection with underwriting activities

- including actuarial fees but excluding fees in relation to the affairs of the agency in managing the syndicate eg legal advice on capacity offers etc.

Usage of assets for the affairs of the syndicate

- including fixed asset charges, amortisation, rental and lease costs.

Other expenses

- compliance officer function costs in relation to the affairs of the syndicate;
- cost associated with the assessment of technical provisions including US reporting, run-off years and solvency;
- cost of production of syndicate reports including data processing, syndicate financial and regulatory reporting (eg quarterly returns, business plans);
- business acquisition costs which relate to underwriting, eg costs of establishing service companies, purchasing portfolios of business etc;
- user pays charges attributable to syndicate activities.
- travel expenses connected with the business of the syndicate and which are for the benefit of the syndicate members;
- irrecoverable VAT on expenses chargeable;
- management charges levied by the managing agent relating to the usage of fixed assets by the syndicate;
- RITC work;
- the regulatory levy.

ANNEX 2:
Examples of expenses considered "not acceptable"

Salaries and related costs

- employment costs including salaries, benefits, pensions and other costs such as compensation for loss of office for staff engaged in corporate work (wholly or, as apportioned, partially).
- compensation for loss of office paid to staff which is in excess of more than one year's salary.

Other expenses

Examples of other expenses which are considered unacceptable include:

- members' agent expenses for combined agents, including costs of recruitment of members to a syndicate;
- central costs of the managing agent, including for example:
- corporate costs relating to directors, officers and employees (ie the proportion of salary-related costs allocated to the agent);
- costs incurred in relation to any loss review of a managed syndicate;
- audit fee for statutory accounts of managing agents;
- premium paid for agent's errors and omissions insurance;
- financial penalties imposed by the Inland Revenue for late submission of tax computations/late payment of tax;
- financial penalties imposed by Lloyd's under its disciplinary arrangements;
- insurance of managing agent assets as allocated on the basis of asset usage to the agent.
- corporate fees and subscriptions (eg Lloyd's subscription);
- business acquisition costs other than in respect of underwriting (eg costs of taking over another managing agent).