

# Performance Management - Supplemental Requirements & Guidance

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# Contents

<b>Introduction</b>	4
<b>Approach to Performance Issues</b>	6
<b>Performance Management Requirements and Guidance</b>	
Franchise Guidelines	8
Overwriting	11
Rate Reductions	12
Shared Reinsurance Arrangements	13
Disclosure of Related Party and Other Transactions which May Give Rise to a Conflict of Interest	14
BIPAR Principles	15
Distribution Costs, Broker Remuneration and Additional Charges	16
“Grossing Up”/Net-Equivalent Clauses	20
Reinsurance to Close	21
Special Termination/Downgrade and Funding Clauses	23
General insurance Contracts Involving Risks Relating to the Death of an Individual	24
Political Risk & Credit Claims Statement of Best Practice	25
Market Reform Contracts/Contract Certainty	25
<u>Inception Date Allocation</u>	26
Underwriting Stamp/Use of Lloyd’s Anchor	27
Underwriting in the Room	29
Recruiting Staff – Protecting Confidentiality of Third Party Information	30
<b>Classes Subject to Special Approval</b>	
War & NCBR Exposures	31
Financial Guarantee	33
Construction Project Risk	37
Unlimited Medical Expenses Cover	38
Term Life	38
Viatical & Life Settlements/After The Event Insurance	38
Retrospective Reinsurance	39
Affordable Care Act	40
<u>US and Canadian Cannabis/Marijuana Risks</u>	40
Tax & Wealth Strategy Schemes	43
<u>Cryptocurrencies, decentralised digitised assets &amp; related transactions</u>	44
<b>Appendix 1</b>	47

## Abbreviations

In this document, the following abbreviations have been used:

<u>ECA:</u>	<u>Economic Capital Assessment</u>
GNP:	Gross Net Premium
<u>GWP</u>	<u>Gross Written Premium</u>
PMD:	Performance Management <u>Directorate</u> <u>Division</u>
PMDR:	Performance Monitoring Data Review
RDS:	Realistic Disaster Scenario
RITC:	Reinsurance to Close
SBF:	Syndicate Business Forecast
SCR:	Syndicate Capital Requirement
<u>SP:</u>	<u>Syndicate Performance team</u>
<u>SGP:</u>	<u>Stamp Gross Premium</u>
<u>SUP:</u>	<u>Syndicate Underwriting Performance team</u>

Other abbreviations are defined in the relevant section where they are used.

## Introduction

This document sets out supplemental requirements and guidance that relate to performance management in the Lloyd's market.

### Background

Lloyd's performance management framework provides that managing agents may only underwrite on behalf of the members of a syndicate in accordance with a business plan that has been agreed by Lloyd's. Lloyd's also prescribes a number of Minimum Standards which managing agents are expected to meet (available at [www.lloyds.com/minimumstandards](http://www.lloyds.com/minimumstandards)).

In addition, in a number of areas, PMD has issued supplemental requirements and guidance which relate to performance management issues. In a number of cases these requirements have been concerned with the underwriting of particular classes of business. In many instances, Lloyd's considers that compliance with these requirements is a matter of prudential concern for the market.

Whereas in the past, these requirements have been issued in the form of Market Bulletins or as emails, they are now consolidated in this document. The intention of this document is to provide managing agents with a single point of reference for Lloyd's supplemental performance management requirements and guidance. It supersedes and replaces the earlier Market Bulletins or emails covering the same topics.

### Scope of this document

The requirements and guidance set out in this document are supplemental to Lloyd's requirements as set out in Lloyd's Byelaws and Minimum Standards.

While this document includes requirements and guidance that are relevant to all parts of PMD the topics covered are primarily concerned with underwriting and business plan matters. This document does not cover delegated authority requirements, which are addressed separately, including in the Code of Practice – Delegated Underwriting Authority.

This document also does not include requirements or guidance that are specific to compliance with the Lloyd's annual timetable. These matters will continue to be dealt with in Market Bulletins or emails to the market.

Where managing agents are in any doubt as to the application of the requirements or guidance set out in this document they should raise the matter with the relevant account executive.

### Updates to this Document

This document updates and replaces the version of this document issued in ~~September 2014~~ May 2016.

It is intended that this document will be updated and supplemented at regular intervals.

Lloyd's will continue to communicate performance management related requirements to the market through emails and Market Bulletins. Where

appropriate, they will be consolidated into subsequent versions of this document.

A copy of this document can be downloaded from [www.lloyds.com/supplementalrequirements](http://www.lloyds.com/supplementalrequirements).

## Approach to Performance Issues

The following principles have been shared with the market and endorsed by the Franchise Board.

These follow Lloyd's general approach to working with the market and each managing agent, taking account of individual circumstances and with the intention of responding with commercial common sense. The principles also reflect earlier messages to the market relating to the Minimum Standards implementation.

These principles were first circulated to the market at the request of the Franchise Board in July 2007 so that everyone would have a common understanding.

### Monitoring & measurement

- 1 The Performance Framework consists of enforceable Standards:
  - a. to ensure fairness for all managing agents
- 2 These Standards apply to all businesses trading at Lloyd's:
  - a. devised for the protection of all market sectors
- 3 Meeting the Standards should be 'business as usual' good practice:
  - a. not a 'regulatory burden'
- 4 Lloyd's requires all managing agents to at least meet the minimum Standards and encourages those currently exceeding them, or planning to exceed them:
  - a. Minimum Standards are a floor and not a ceiling for performance.
- 5 Each managing agent can choose how best to meet the stated Standards:
  - a. as long as that capability can be demonstrated
- 6 Lloyd's will take a risk-based approach to Standards in general:
  - a. taking account of the probability and potential scale of failure
  - b. recognising that solutions can vary between firms with a range of scale and complexity
- 7 The expectations of our Regulator must always be met.
- 8 Standards will be periodically reviewed to ensure that they remain appropriate to the Lloyd's market's needs. This could involve the adjustment of existing standards and the addition of new standards, in response to changing circumstances.
- 9 Lloyd's role is to ensure that minimum Standards are met, while providing support and adding value wherever possible

### Response to performance

- 10 Consistently superior performance will be recognised:
  - a. within the SCR risk assessment and consequent capital requirement
  - b. by a lesser degree of oversight being exercised by Lloyd's
  - c. allowing for the agreement of more flexible business plans and for changes to those plans to be readily agreed

- 11 Lloyd's response to failure to meet minimum Standards will be to:
- a. engage and listen to the managing agent involved
  - b. establish the facts
  - c. protect the interests of the members of the syndicate in question, the managing agent and the market generally, acting with discretion and taking a commercial perspective
  - d. seek resolution via agreed action plans wherever feasible
  - e. ensure that any actions are fair and proportionate having regard to the level of risk to which the syndicate, the managing agent or the market are exposed (Lloyd's has extensive options regarding under-performance using the Underwriting Byelaw, as well as through the business planning and SCR processes)

# Performance Management Requirements and Guidance

## Franchise Guidelines

The guidelines set out below were developed by Lloyd's to help managing agents to optimise and, where necessary, improve the performance of their syndicates. The guidelines (subject to being updated) derive from the Chairman's Strategy Group (CSG) consultation document and were arrived at following extensive consultation with the market.

Each managing agent is expected, under normal circumstances, to operate its business within the guidelines. If a managing agent wishes to operate outside the guidelines in respect of a syndicate, it will need to discuss its position and obtain a dispensation in advance from Lloyd's.

It is not intended that the guidelines should be blindly applied to every syndicate and on every line of business. Lloyd's will consider requests for dispensations if a robust argument can be made to justify the dispensation.

Each Franchise Guideline is stated below. This is followed, where relevant, by guidance in respect of that guideline.

### 1 Profitability by product line

There should be a reasonable expectation of making a gross underwriting profit on each line of business every year.

### 2 Catastrophe exposure

- a. Catastrophe exposure should be analysed using tools or methods that are approved by Lloyd's.
- b. A Syndicate's 'AEP 1-in-30 Whole World' modelled loss, projected and in-force, shall not exceed 110% of ECA plus Profit for Gross Losses and 45% of ECA plus Profit for Final Net Losses. Each managing agent should manage to a minimum return period agreed by Lloyd's.
- c. For all other cat risk metrics, as prescribed by Lloyd's in its RDS Guidance and Instructions Document, projected and in-force loss estimates shall not exceed 80% of ECA plus Profit for Gross Losses and 30% of ECA plus Profit for Final Net Losses. The maximum gross and final net exposures to a single Lloyd's specified Realistic Disaster Scenario (RDS) event for a syndicate are subject to a threshold of up to 80% and 30% of syndicate ECA respectively.

'Profit' for this purpose shall be defined as 'Profit/Loss for the period' on an Ultimate basis in the approved Year of Account SBF (item 16 of SBF Form 100s)

#### - Guidance

In reviewing a syndicate's management of gross and net catastrophe exposures to minimum return period/specified RDS events, attention will be paid not only to overall syndicate capital, but also to:

- The net written premium allocated by the syndicate to the line of business

- The level of expected underlying profitability in the line of business absent major catastrophic events
- The level of expected profitability in the other lines of business written by the syndicate, and the degree of inherent volatility in those other lines
- The quality, nature and effectiveness of the reinsurance protecting the gross exposures; in terms of the overall scale, types of product purchased, the legal and structural strength of the contracts involved, the financial strength and concentration levels of the reinsurance counterparties involved, and the quantity and quality of any supporting collateral arrangements
- The overall liquidity of the syndicate, and its ability to meet any expected regulatory funding requirements
- The assumptions used in ~~calculating RDS~~ modelling catastrophe exposures, and
- The managing agent's capability and competence

~~This is consistent with the intent of the existing guidelines, and the CSG consultation document statement that "The capacity, (and hence capital), The purpose of this guideline is to ensure that the capital of any syndicate (and ultimately the Central Fund) should not be threatened to a considerable~~ an unreasonable or unexpected extent by catastrophe losses ~~any one RDS event. [Managing agents] cannot be allowed in future to risk unreasonable exposures to their syndicate's own capital or the Central Fund in this way".~~

### 3 Reinsurer selection

Each managing agent should have an approved reinsurer selection process.

### 4 Gross line size

The maximum gross line that a syndicate should have on an individual risk is 8% of ~~gross written premium~~ GWP.

#### - Guidance

In reviewing a syndicate's gross line sizes on individual risks for any class of business, attention will be paid not only to overall syndicate GWP ~~gross written premium~~, but also to:

- The ~~gross written premium~~ GWP allocated by the syndicate to the line of business
- The level of capital
- The risk characteristics of the line of business, and the level of expected profitability in that line
- The level of expected profitability in the other lines of business written by the syndicate, and the degree of inherent volatility in those other lines
- The quality and nature of the reinsurance supporting the gross line size
- The quality, nature and effectiveness of the reinsurance protecting the gross line size (including the overall scale, types of product purchased, the legal and structural strength of the contracts involved, the financial strength and concentration levels of the reinsurance counterparties involved, and the quantity and quality of any supporting collateral arrangements)
- Line size utilisation, and
- The managing agent's capability and competence

This is consistent with the intent of the existing guidelines, and the CSG consultation document statement that “Individual risks should not be allowed to threaten large portions of a syndicate’s capital”.

For the sake of clarity it is emphasised that it is not the intention simply to apply guideline percentages of syndicate ~~gross written premium~~ GWP to the premium allocated to the line of business, or to capital.

## 5 Reinsurance leverage

- a. Each syndicate should retain a net minimum amount of exposure on each risk (e.g. 10% of gross line).
- b. No syndicate should pursue an aggressive arbitrage strategy (e.g. building business using inadequate pricing on the back of reinsurance).

### - Guidance

Since the guideline refers to a minimum net retention on each risk as a percentage of the gross line, obviously the considerations detailed above in relation to gross line size, will impact the net retained line.

The key consideration as regards reinsurance leverage (as highlighted in the CSG consultation document) is the avoidance of aggressive arbitrage, ie reliance on reinsurance cover to compete at uneconomically low premiums. This is also consistent with the Profitability by Product Line guideline, which states that “There should be a reasonable expectation of making a gross underwriting profit on each line of business every year.”

Where there is a significant difference between the gross and net line size, the matching of reinsurance coverage to the underlying exposures, will also be an important factor in considering any variance from the guidelines. However, account will be taken of the availability of matching reinsurance.

In addition to ensuring that syndicates place their reinsurance with reputable, secure reinsurers, Lloyd’s will be keen to ensure:

- That any reinsurance arrangements shared with non-Lloyd’s entities provide the appropriate level of protection and are not disadvantageous to the syndicate(s) concerned, (e.g. in terms of coverage availability, equitable sharing of premiums and reinstatement premiums etc.). (See further below – Shared Reinsurance Arrangements)
- That any finite risk reinsurance arrangements are fully transparent and provide the appropriate level of protection, and
- That undue concentrations of reinsurance with individual reinsurers are avoided or minimised

## 6 Multi-year policies

- a. Non-cancellable policies covering a period of greater than 18 months should be recorded as multi-year policies.
- b. Multi-year policies should either have matching reinsurance cover or be limited to the agreed maximum net exposure to the class of business as set out in the syndicate’s business plan.

- Guidance

Account will be taken of the availability of reinsurance protection which matches the vertical limits to be written, the policy periods written, the terms and conditions of the inwards policies, plus the adequacy of the reinstatement protection.

~~Account will be taken of the availability of matching reinsurance.~~

Managing agents (together with their auditors, where appropriate) are responsible for deciding whether reallocation of premium is appropriate on multi-year policies (ie contracts where the overall period of risk exceeds 18 months and the costs and/or benefits under the contract may affect more than one year of account). See [Market Bulletin Y3993](#) which includes a brief summary of the key legal and accounting principles relating to the allocation of premium.

7 Overall market dominance by a managing agent

No managing agent should write more than 15% of the overall market gross net premium without the prior agreement of Lloyd's.

## Overwriting

Overwriting is writing more ~~Stamp Gross Premium (SGP)~~GWP at a whole account level than has been approved by Lloyd's for the year of account in question as stated in the most recent SBF approval letter or where the ~~SGP~~GWP for a particular class is materially greater than that stated in the most recently approved SBF for that particular class.

### The procedure for obtaining Lloyd's agreement to overwrite

If a syndicate wishes to overwrite, its managing agent must obtain prior approval from ~~SP~~the SUP team who, in conjunction with the managing agent, will determine if a revised SBF and SCR needs to be submitted.

Note:

- Agents should contact their ~~SP Manager~~SUP executive if they require clarification as to whether a particular variance of ~~SGP~~GWP for a class of business would be considered 'material'. The key considerations will include the size of increase and the impact on capital requirements resulting from a change in the composition of the whole account portfolio.
- The ~~SP~~SUP team use the Quarterly Monitoring Return (QMB) and form 163 of PMDR to assess the expected premium volume for the year. The ~~SP~~SUP team takes into account fluctuations in exchange rates when monitoring premium volume. This ensures that Lloyd's is comparing the plan and PMDR on as consistent a basis as possible.
- The requirement to inform the ~~SP~~SUP team of overwriting is derived from the Underwriting Byelaw, which requires that managing agents should write in accordance with a syndicate's approved business plan and provides that managing agents should notify Lloyd's where they deviate from the plan (paragraphs 25 and 26). There is also a separate requirement on managing agents under the Underwriting Byelaw to take

reasonable steps to ensure that they do not write in excess of the syndicate's capacity (as calculated based on Gross Net Premium) (paragraph 37).

## The implications of overwriting

If a syndicate has identified that it may overwrite or if it wishes to obtain Lloyd's ~~approval agreement~~ to overwrite, the SPSUP team will wish to discuss the following points:

- The reasons for overwriting – ie due to new business, better rates, failure of controls etc
- The effect of overwriting on the syndicate's capital requirements
- If applicable, any franchise guideline dispensations
- The procedure taken for notifying the syndicate's capital providers and whether their approval has been obtained
- Whether the SBF and SCR need to be resubmitted
- The profitability of any additional premium and the impact on class and syndicate performance

Managing agents of non-aligned syndicates should note that the ability of Lloyd's to agree to any overwriting may be more limited. In particular, Lloyd's may be more constrained in agreeing to overwriting where this would require additional capital to be provided mid-year. In addition, any permission to overwrite will only be on the basis that the syndicate remains within its syndicate capacity. Lloyd's will discuss managing agent's options in these circumstances on a case by case basis.

Where a syndicate fails to notify the SPSUP team that it may overwrite and subsequently the QMB, PMDR or other core market returns show that the syndicate has actually overwritten, the SPSUP team will, in addition to the above considerations, also wish to review the effectiveness of management controls. The risk of premium volumes exceeding plan will be taken into account when agreeing both business plans and SCRs.

## ~~Performance~~ Premium monitoring

Lloyd's uses QMB, PMDR and other core market returns to monitor several aspects of performance, one of these being the amount of SGP-GWP written. More specifically Lloyd's looks at:

- Whether SGPGWP is in line with the approved plan and if there is a potential for overwriting compared to the plan.
- For non-aligned syndicates whether there is the potential to overwrite syndicate capacity.
- Comparison to previous years written premium development patterns.

If as a result of analysis of the QMB and PMDR (and any other relevant data sources), the SPSUP team identifies that current SGPGWP volume when trended for ultimate development is likely to exceed plan, the SPSUP team will inform the managing agent accordingly and seek confirmation from them in writing as to their position. In the first instance, however, it is for managing agents to monitor premium volumes against their approved plans, in order to identify if they are likely to overwrite and to take appropriate action, including notifying the SPSUP team.

## Rate Reductions

Rate or pricing reductions occur when there is market softening and ~~will~~ may result in the Risk Adjusted Rate Change (RARC) achieved by a syndicate being lower than planned. In such circumstances, it will usually be the case that syndicates will either write less business than planned to maintain the same rate adequacy or that the price adequacy on business written will be less than planned, potentially resulting in a higher loss ratio than planned in the SBF. In both circumstances, there may be a consequential effect on profitability and the Insurance Risk element of the syndicate's approved SCR.

If a syndicate expects that rate or price reductions may result in its performance materially deviating from its approved business plan then its managing agent must inform its SP Manager SUP executive who, in conjunction with the managing agent will determine if a revised SBF needs to be submitted. The agent must also assess the impact on capital and in conjunction with Lloyd's determine if a re-submission of the SCR is required.

A similar and equivalent approach will be adopted by SPSUP for considering and monitoring pricing rate reductions as that set out in the section on Overwriting.

As highlighted in the section on Overwriting, the requirement to inform SPSUP of any material deviation from the SBF is derived from the Underwriting Byelaw (paragraphs 25 and 26), which requires that managing agents should write in accordance with a syndicate's approved business plan and provides that managing agents should notify Lloyd's where they expect to deviate from the plan.

## Shared Reinsurance Arrangements

Managing agents are reminded that paragraph 18 of the Multiple Syndicates Byelaw imposes restrictions on managing agents wishing to reinsure two or more syndicates managed by it under the same contract. Restrictions also apply to the reinsurance between two syndicates managed by the same managing agent (see paragraph 19 of the Multiple Syndicate Byelaw).

In respect of all shared reinsurance arrangements (both where the benefit of the reinsurance is shared with another Lloyd's syndicate and where it is shared with a non-Lloyd's company):

- 1 The managing agent will use its best endeavours to secure a non-avoidance clause on all shared reinsurances to ensure that in the event of reinsurers entering into a dispute with a reinsured other than the syndicate, reinsurers will continue to honour their contractual obligations to the syndicate and will not seek to void the reinsurance contract with the syndicate as a result of that dispute.
- 2 The premium payable for all shared reinsurance will be allocated in a clearly defined and equitable manner reflecting the relative exposures of each reinsured entity.

- 3 Where a recovery is made under any layer of shared reinsurance, the limit(s) and deductible will be apportioned in the ratio that each reinsured's paid loss bears to the total claims paid by the syndicate and other reinsureds.
- 4 Where a recovery is made under any layer of shared reinsurance, reinstatement premiums will be apportioned between the syndicate and other reinsureds in the same proportion as the recovery.
- 5 In the event that the incurred position on the 1st layer on any shared reinsurance programme reaches 40% of the total cover available on that layer, the managing agent will advise Lloyd's in order to discuss the need to obtain additional protection.
- 6 All reinsurance is rated A- or higher by AM Best, or A or higher by Standard & Poor's, unless otherwise agreed by Lloyd's. Confirmation is submitted to Lloyd's that the board of the managing agent is satisfied that each shared reinsurance is in the best interests of the members of the syndicate.
- 7 The shared reinsurances are notified to the PRA.

## Disclosure of Related Party and Other Transactions which May Give Rise to a Conflict of Interest

As part of the business planning process, Lloyd's requires managing agents to disclose details relating to any association or current or proposed underwriting transaction which may give rise to a conflict of interest. These requirements derive from paragraph 14A of the Underwriting Byelaw.

Since the Legislative Reform (Lloyd's) Order 2008, which repealed the divestment provisions in Lloyd's Act 1982 prohibiting associations between managing agents and brokers, the disclosure requirements in respect of such transactions have been extended to transactions that are placed with or through an intermediary that is a member of the managing agent's own group.

A disclosable insurance transaction will include 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.

Lloyd's considers each of the following to be relevant related parties for the purposes of disclosure:

- 1 any company within the same group as the managing agent

- 2 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
- 3 any company which has two or more directors in common with the managing agent
- 4 another syndicate managed by the same managing agent or a service company coverholder that is part of the managing agent's group
- 5 any insurance special purpose vehicle company where the key management services are undertaken by persons who are employed by a company that meets any of the points 1 to 3, where those persons have authority and responsibility for planning, directing and controlling the activities of the insurance special purpose vehicle company, whether or not they are a formally recognised as directors or officers of the insurance special purpose vehicle company

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

Each managing agent is further required as part of the business planning process to provide 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 the applicable Lloyd's, PRA or FCA rules.

Although the disclosure requirements form part of the business planning process, to assist managing agents, the full disclosure process is dealt with outside the normal business planning timetable and a separate request for the information is sent to the market early in each underwriting year of account when the managing agent will have the final details for the prior years of account.

Managing agents should note that in addition to the specific requirements for disclosure set out above there is a general requirement in paragraph 14A of the Underwriting Byelaw to disclose information relating to any association or current or proposed underwriting transaction which may give rise to a conflict of interest. Any such disclosure should be made to the managing agent's SP Manager~~SUP account executive~~.

Managing agents are required to make available to members of the relevant syndicate (or their members' agents) the information referred to above. Members' agents are required to make sure this information is drawn to the attention of their members (paragraph 23A).

Managing agents will be aware that there are separate obligations to disclose related party transactions when preparing syndicate annual accounts. So that it can prepare the Aggregate Accounts, Lloyd's also requires managing agents annually to provide details of related party transactions where the transactions are material and have not been concluded under normal market conditions. This is coordinated by the Market Finance team as part of the annual syndicate report and accounts process.

## BIPAR Principles

Lloyd's wishes managing agents to conduct insurance business at Lloyd's in full compliance with European and UK competition law.

Following the publication of a final report on 25 September 2007 by the European Commission on its inquiry into the business insurance sector, the European Federation of Insurance Intermediaries (BIPAR) developed High Level Principles which are intended for use by brokers as a general guide in relation to placement of a risk with multiple insurers. These principles are can be found here at <http://www.bipar.eu/en/key-issues-positions/principles>. As part of the ongoing development of co-insurance arrangements, and in conjunction with the BIPAR High Level principles, Lloyd's wishes to remind managing agents and their underwriters of their obligation to comply with competition law and, in particular, that –

- 1 Brokers must seek to place business as they see fit having regard to the interests of their client. That may involve brokers inviting following underwriters to subscribe to a risk on identical contractual terms and conditions as the lead underwriter other than premium.
- 2 Where underwriters receive such an invitation, they should give careful, independent consideration to it. Following such independent consideration, the underwriter may decide to quote or subscribe to the risk at a different premium from the lead underwriter or, as with any risk, decline to quote or subscribe to it.
- 3 In any co-insurance placement, underwriters may, but are not obliged to, follow the premium charged by the lead underwriter;
- 4 Underwriters should not use "best terms and conditions" clauses or engage in market practice which has the same effect unless they have first obtained legal advice that the use of such a clause or practice would be lawful and contract certain in the circumstances of a particular case. The Commission's definition of such clauses is as follows –

*"any stipulation, whether written or oral, introduced at any stage of the negotiation of a reinsurance contract, by means of which a (re)insurer A obtains, seeks to obtain or acquires the right, under certain circumstances, to obtain an alignment of its proposed or agreed terms and conditions, in particular the premium, to the terms and conditions ultimately obtained by any other (re)insurer B participating in (re)insuring the same (re)insured as A, in the event that the latter terms are more favourable to the (re)insurer, than the terms and conditions which A offered or subsequently agreed."*

## Distribution Costs, Broker Remuneration and Additional Charges

Placement structures and remuneration arrangements in the London market continue to evolve and increase. Whilst Lloyd's does not seek to interfere with the agreement of commercial arrangements in the market, nevertheless it is important that managing agents continue to consider properly the structure and terms of such arrangements to ensure their

compatibility with relevant laws and regulations and to meet the very highest standards in their dealings with brokers for the benefit of Lloyd's policyholders.

## Bribery Act

The Bribery Act 2010 (the "Act") is in force and all managing agents must make sure that they continue to consider the implications of the Act (and the associated guidance issued by the Ministry of Justice). In summary, the Act provides that it is both an offence to offer, promise or give bribes (active offences) and to request, agree to receive or accept a bribe (passive offences). The Act also introduced corporate liability for failing to prevent bribery.

It is ultimately a matter for the board of each managing agent (taking its own external legal advice where appropriate) to ensure that any arrangement that a managing agent enters into does not breach the terms of the Act.

The consequences of breaching the Act are very serious and any criminal charges would be a matter for the Serious Fraud Office (rather than Lloyd's or the FCA). Lloyd's continues to expect managing agents to adopt a very cautious and rigorous approach to compliance having regard in particular to the following matters.

### ~~Ordinary~~ Brokerage

The payment of brokerage within the usual range is a long-standing commercial practice that has consistently been upheld by the courts as compatible with brokers' and insurers' fiduciary duties. Accordingly, Lloyd's has been advised and has concluded that it is inconceivable that agreement or payment of brokerage would lead to prosecution where the amount agreed is an ~~ordinary~~ amount within the usual range for the type of business in question and where the amount has been fully disclosed to the client.

### Additional fees charges and commissions

Payment by the insurer of additional fees, charges or commissions (or brokerage outside the ~~ordinary-usual~~ range) to a broker which acts for a policyholder, including under a line slip (rather than as agent for underwriters under a binding authority), raises concerns that the additional payment might be seen as inducing or influencing the broker to place business with the insurer contrary to the broker's client's best interests, or which might otherwise cause improper performance by the broker of its duties. This is particularly the case where the additional payments are calculated by reference (whether directly or indirectly) to the amount of business underwritten by the insurer or by reference to the profitability of the business.

Considerable care therefore needs to be taken before any such additional payments are agreed having regard to the underlying commercial reality of the arrangement in question rather than merely to how it is represented or described.

Accordingly, Lloyd's expects each managing agent to continue to ensure that, as a minimum, each of the following questions has been considered before additional payments are agreed to –

- 1 no matter how the additional payment is described, is the real commercial motivation to agree to the additional payment to secure underwriting business or the opportunity to quote for such business? If so, the additional payment should not be agreed to without the managing agent obtaining its own legal advice which specifically addresses the commercial motivation for the additional payment.

Subject to the guidance below on line slip and binding authority arrangements, in no circumstances should additional payments be agreed, with an intermediary acting on behalf of the client, which are contingent upon the profitability of business being entered into or which are contingent upon receiving target volumes of business which represent a very high risk under the Bribery Act;

- 2 is the additional payment compatible with the managing agent's obligation to pay due regard to the interests of Lloyd's customers and treat them fairly at all times?
- 3 where the additional payment is said to be in return for any services provided to the insurer (whether for administrative services, provision of management information or otherwise) –
- a. are the services of real additional value to the managing agent and demonstrably commensurate with the additional payment? If not, the additional payment should not be agreed to or arrangements should be negotiated in good faith so that the value of the service is objectively and demonstrably commensurate with the additional payment;
  - b. are the services fully defined and set out in a contractually binding agreement which would meet equivalent PRA and FCA outsourcing requirements (see SYSC 13.9) and (a) allow proper monitoring and control of the services, (b) allow access to the managing agent's internal and external auditors to review the provision of the agreed services and (c) make the broker legally responsible for providing the services and accepting liability for failure to do so. If not, the additional payment should not be agreed to without the managing agent obtaining its own legal advice;
- 4 has the broker agreed to provide clear and readily comprehensible disclosure to its clients in respect of each contract of insurance placed for each client of (a) the amount of the additional payment and (b) of any services for which they are paid? If not the additional payment should not be agreed;
- 5 can the broker demonstrate that it has appropriate and proportionate processes and procedures to ensure that it and its staff will continue to perform their fiduciary duties to their clients in all of the circumstances? If not, the additional payment should not be agreed to. The confirmations and undertakings that a broker provides under the ~~new (2013) model non risk transfer~~ and risk transfer Terms of Business Agreements ('TOBA') ~~published by LMA and LIIBA, (or the new model endorsement to the risk transfer TOBA)~~ including in relation to the Bribery Act, are likely to be sufficient for these purposes.

Where a managing agent does consider that it is appropriate to agree additional payments the managing agent must keep a clear record of how it reached that decision.

It is important that each managing agent agreeing to additional payments satisfies itself that the payment is appropriate rather than relying on the fact that other managing agents or insurers may have agreed to enter into the same or similar arrangement.

Where an additional payment has been agreed not at managing agent level but at group level, then the managing agent should consider the above questions when considering a proposal to recharge any of the additional payment to the syndicate.

### **Supplementary guidance with regard to profit commission on line slips**

It is understood that currently some line slips do permit profit commission for the named broker. Profit commission ("PC") represents a high risk under the Bribery Act. This is because an agreement between a managing agent and a broker which rewards the broker for placing (profitable) business with the managing agent raises clear concerns that the broker may be influenced to place business with that managing agent even where that is otherwise contrary to its duties to its client. In this regard it is important to bear in mind that under a line slip the broker remains the agent for its client (the insured). (This is in contrast to the position where a broker acts as agent for underwriters under a binding authority, which includes under a "limited" or "prior submit" binding authority.)

However, the legal risks regarding agreement of PC under a line slip are likely to be materially less where the managing agent is reasonably satisfied that –

- a. the broker has expressly stated to its client that it will not be undertaking a fair market analysis when seeking terms for the client (but instead will seek to place the business under the line slip); and
- b. the broker has disclosed, or will disclose, the remuneration arrangements to its client in accordance with the broker's duties under ICOBS and in accordance with any additional fiduciary duties it owes its client; and
- c. the broker is, when required or requested to disclose the remuneration it receives under the line slip, expressly providing the client with details of the level of the PC and basis of calculation.

In the case where the client is separately paying its broker a fee, and the managing agent is aware of this arrangement, then the managing agent should satisfy itself that the broker is disclosing the remuneration details (including the PC) in respect of each contract of insurance whether or not the client specifically requests disclosure.

The broker is under an ICOBS obligation always to state to its client whether or not it is operating on a fair analysis basis or only dealing with a limited number of insurers (or one only) (ICOBS 4.1.6R).

In these circumstances, and where the managing agent is satisfied that the broker has appropriate processes to comply with its regulatory and fiduciary obligations and adequate procedures under the Bribery Act, the managing agent may decide that allowing PC is acceptable since the concern that the broker might improperly perform its duties to its client to seek best terms would not arise.

## Supplementary guidance with regard to profit commission on binding authorities

In some cases binding authorities provide for profit commission to be payable to both the coverholder and also to the Lloyd's broker which placed the binding authority on behalf of its client (the coverholder). Where –

- a. the Lloyd's broker's only role is acting for the coverholder in placing the binding authority (and not acting for the ultimate policyholders); and
- b. where the profit commission arrangement for the Lloyd's broker is included in the binding authority

then there should not be a concern from the Bribery Act. This is because the broker's client (the coverholder) is a party to the binding authority agreement permitting the profit commission.

## Reporting to Lloyd's

A managing agent which has entered into an arrangement with a broker which involves additional payments must continue to notify ~~the Performance Management Directorate as follows~~, PMD in its Quarterly Broker Remuneration return, in line with guidance provided.

Managing agents are not required to notify Lloyd's in advance of all new arrangements before they are entered into, unless –

- a. they are material to the managing agent's business, or
- b. the management agent believes that the agreement presents a significant risk, even if this risk will be appropriately managed and mitigated through internal governance and controls.

Where the managing agent believes it to be appropriate, notification should be made using the following email address: [distributioncosts@lloyds.com](mailto:distributioncosts@lloyds.com).

New agreements should be included and flagged in the Quarterly Broker Remuneration return.

- ~~1 Managing agents should notify the Directorate of all additional payments however described (other than ordinary brokerage). This includes all such additional payments whether provided for on the slip or on a line slip (other than PCs on lineslips in which case the disclosures provided by the Quarterly Broker Remuneration returns will suffice).~~

~~These initial notifications should be provided using the following email address: [distributioncosts@lloyds.com](mailto:distributioncosts@lloyds.com). Prior approval or consent is not required.~~

- ~~2 Managing agents must also continue to report to the Performance Management Directorate all new arrangements before they are entered into and must account for all amounts booked in that quarter using the Quarterly Broker Remuneration form. This form includes disclosing PC paid under lineslips.~~

~~The form return contains guidance and instructions regarding the nature of the disclosures that must be made. This form return and its guidance may be updated and refined over time and any updates will be communicated to the market. More information on quarterly reporting can be found at~~

~~[www.lloyds.com/business timetable](http://www.lloyds.com/business timetable) on the [Business Timetable tool](#) on [Lloyds.com](#).~~

For the avoidance of doubt these reporting obligations include where the managing agent has decided as a matter of strategy to make payments for services rather than payments that relate to individual insurance contracts. The reports should also cover additional payment arrangements which have been entered into at a group level but where some or all of the payment is to be recharged to the syndicate.

If a managing agent is in doubt whether an additional payment should be reported please contact [distributioncosts@lloyds.com](mailto:distributioncosts@lloyds.com) or your usual ~~Syndicate Underwriting Performance account executive~~ Syndicate Performance Manager.

(Note that the LMA has obtained legal advice for its members from Reynolds Porter Chamberlain on broker remuneration. A summary of that advice is available at [www.lmalloyds.com/LTM11-013-KK](http://www.lmalloyds.com/LTM11-013-KK).)

## “Grossing Up”/Net-Equivalent Clauses

Grossing up is a practice whereby the gross premium (ie including commission) agreed between broker and insurer (or reinsurer) is less than the premium which the broker notifies the proposed policyholder is payable. The difference between the two amounts remains in the hands of the broker and the proposed policyholder is left unaware that ~~he is~~ they are paying a greater sum than has been agreed by the broker on ~~his~~ their behalf with the insurer (or reinsurer).

Such a practice, without the informed consent of the proposed policyholder, is wholly unacceptable and is a breach of the agency duties which the broker owes the policyholder as its principal.

In certain cases, slips have contained wordings which have allowed the broker to adjust the gross premium while the underwriter receives the same net premium (for example, contracts with an “or net equivalent” clause).

In view of the concerns that can arise from “grossing up” and the difficulties in ensuring that there is appropriate policyholder consent, managing agents should not include clauses in contracts where the commission is expressed as a net equivalent and may be varied by the broker, unless the commission appearing on the slip is expressed as a specific sum or maximum amount which can only be reduced.

## Reinsurance to Close

### Documentation of RITC contracts

Managing agents closing open years of accounts of syndicates under their management must ensure that any reinsurance to close is properly documented in a Contract of Reinsurance to Close. This requirement applies to all syndicates closing years of account where there is more than

one member of the syndicate on either the reinsuring year or on the reinsured year. This also applies where both the reinsuring and reinsured year consists of a single member but where the legal identity of the reinsured and reinsuring member is different.

Where the syndicate has one member which is the only member on both the year of account that is being closed and on the year of account into which the open year is being closed, no reinsurance to close is required. The managing agent of the syndicate must, however, ensure that it complies with all other accounting and Lloyd's requirements for closing syndicate years of accounts.

### **Mandatory terms in contracts**

Every contract of reinsurance to close underwritten by members of a syndicate shall, unless Lloyd's otherwise agrees (whether generally or in relation to a particular case) include express terms to the following effect –

- 1 the reinsuring members unconditionally agree to indemnify the reinsured members, without limit as to time or amount, in respect of the net amount of all known or unknown losses, claims, refunds, reinsurance premiums, outgoings, expenses and other liabilities (including extra-contractual obligations for punitive or penal damages and obligations to provide regulatory redress as a result of policyholder complaints) arising in relation to the underwriting business of the syndicate for the reinsured year of account (and earlier years of account of the same or any other syndicate reinsured to close into that year of account) (the "underwriting business") after taking account of all amounts recoverable by the reinsured members under syndicate reinsurances in respect of those liabilities and actually recovered on or after the inception date of the contract;
- 2 notwithstanding that the indemnity under the contract is against liabilities net of syndicate reinsurance recoveries or that the ultimate net liability of the reinsuring members may not yet have been ascertained, the reinsuring members shall discharge or procure the discharge of the liabilities of the reinsured members;
- 3 either:
  - a. the rights to receive all premiums, recoveries and other monies recoverable at any time in connection with the insurance business of the reinsured members are assigned to the reinsuring members by the contract or are to be assigned on their subsequent request; or
  - b. the reinsuring members are authorised by the reinsured members to collect on behalf of the reinsured members the proceeds of all such rights and retain them for their own benefit so far as they are not applied in discharge of the liabilities of the reinsured members;
- 4 the reinsuring members are required and fully, irrevocably and exclusively authorised on behalf of the reinsured members to conduct the underwriting business, and authorised to sub-delegate that authority to the reinsuring members' managing agent and to any person underwriting any RITC of the reinsuring members and to permit the further sub-delegation of the whole or part of that authority in either case; and

- 5 the contract shall not be cancelled or avoided for any reason, including mistake, non-disclosure or misrepresentation (whether innocent or not).

### Multi-reinsurer contracts

No contract of RITC may be underwritten by more than one syndicate except:

- 1 in the case of a contract where the reinsuring syndicates are parallel syndicates; or
- 2 where Lloyd's is satisfied that it is not practicable for the contract to be underwritten by a single syndicate only and that the contract should be permitted to be underwritten by more than one syndicate and grants its consent.

Consent granted under paragraph 2 may be subject to such conditions as Lloyd's thinks fit.

Managing agents should also note that in view of the PRA Rulebook definition of 'approved reinsurance to close', contracts of RITC to be underwritten by more than one syndicate may additionally require the application to the PRA for a modification of SII Firms – Lloyds Approved Reinsurance to Close – Rule 3.1

### Partial reinsurance

Partial RITC involves leaving a year of account open but paying forward a premium to the following year of account by way of reinsurance in respect of that part of the account which the managing agent considers to be readily quantifiable. Partial RITC is not permitted.

### Prohibition of certain exclusion clauses

Where the RITC is to be provided by a syndicate other than a later year of account of the same syndicate ("third party RITC"), potential RITC providers have to inspect accounts and records of the closing syndicate and to ask questions of its managing agent to enable themselves to assess and quote an appropriate premium for the RITC. RITC providers therefore need to be able to rely on what is said to them by managing agents in reply to questions, particularly so where the normal duty of disclosure and the remedy of avoidance for non-disclosure do not apply. Moreover, RITC providers need to be able to rely on replies to such questions without having to load the RITC premium, at the expense of the members of the closing syndicate, to cover the risk of any negligent misrepresentation or misstatement by the closing syndicate's managing agent.

The managing agent of the closing syndicate is not permitted to exclude its duty to its members not to make negligent misrepresentations which might result in the avoidance of reinsurances placed on their behalf. No more so should it be permitted to exclude any reliance by a RITC provider on the managing agent's replies to questions or to exclude any duty of care to the potential RITC provider in replying to questions or any remedy in damages for breach of that duty.

Accordingly, RITC contract wordings shall not include clauses which:

- 1 exclude any reliance by the reinsurer on anything said by the managing agent of the closing syndicate in relation to the contract; or

- 2 exclude any liability on the part of the managing agent of the closing syndicate for any negligent misrepresentation or misstatement made by the managing agent in relation to the contract.

Nothing in this part is intended to alter the requirement set out above that all RITC contracts should include an express term to the effect that the contract shall not be cancelled or avoided for any reason, including mistake, non-disclosure or misrepresentation (whether innocent or not).

## Special Termination/Downgrade and Funding Clauses

It is recommended that managing agents should have a clear policy on what, if any, downgrade clauses and their component parts are acceptable to them.

When considering what downgrade clauses might be acceptable, managing agents should consider and assess the potential risks to the Lloyd's franchise as a whole which may arise as a result of their use.

As a minimum, any policy should provide that, as a rule, the managing agent:

- Will not accept provisions in clauses that, when triggered, require that the syndicate provides collateral for liabilities. It should of course be noted that in a number of territories Lloyd's syndicates already have in place funding or collateralisation arrangements, including through Lloyd's trust funds, to meet local regulations;
- Will not agree to provisions that lead to the returning of earned premium. Premium will not always be deemed to be earned on a proportionate basis. LMA 5140 is an example of a clause that may be used where premium is earned disproportionately, for example on seasonal catastrophe business. Managing agents should also consider their policy on returning premium where a loss has been paid.
- Will only agree to clauses that have a minimum trigger that is considered appropriate by the managing agent. One approach is to require that the clause is triggered only if the rating falls below a minimum rating (such as A-).

Any downgrade clauses used on inwards business should be clear and contract certain.

Lloyd's recognises that there will be cases where a managing agent will not be able to achieve its requirements for special termination/downgrade clauses. A record, however, should be kept of all exceptions.

Managing agents are encouraged to develop more detailed policies as appropriate for their syndicates. The above points Lloyd's believes reflect an appropriate and prudent minimum requirement.

Managing agents may wish to consider using the LMA model downgrade clauses (LMA 5139 and LMA 5140). While managing agents may, of course, use whatever clause they see fit, they should give careful consideration to the operation of the clause selected to ensure that the

prudential risk is properly managed and that, where relevant, it addresses the same issues as those addressed by LMA 5139 and LMA 5140.

The consideration used in selection of any downgrade clause used should be properly documented. Lloyd's may wish to review managing agents' documentation to assess the risk to syndicates and to the market as a whole.

(Note that the Lloyd's Market Association's issued Letter LTM09-025-KJ on 6 October 2009 which should be read together with the requirements set out in this section – available at [www.lmalloyds.com/LTM09-025-KJ](http://www.lmalloyds.com/LTM09-025-KJ).)

## General Insurance Contracts Involving Risks Relating to the Death of an Individual

It is a UK regulatory requirement that managing agents must not permit both general insurance business and long term insurance business (which includes all life insurance) to be carried on together through any syndicate managed by them. It is also a requirement that amounts received or receivable in respect of general insurance business and long term business must be carried to separate premium trust funds.

A number of policies are written by general syndicates in the A&H and contingency market where the contract, amongst other covers provided, may be triggered by the death of an individual (other than accidental death). Typically, in conjunction with other causes of financial loss, these products provide an indemnity for a contractual loss suffered by the insured arising from the death of a named individual. For example, a contingency policy may include cover for a concert promoter for the cost of cancelling an event as a result of the death of the performer.

The particular features of these policies mean that extra care must be taken to ensure that the risks written are appropriate for a general insurance syndicate.

To evidence compliance with the relevant PRA regulations, Lloyd's anticipates that managing agent wishing to write this type of risk will ensure they have suitable legal advice confirming that the business may properly be written by a syndicate writing general insurance business. In obtaining any legal opinion the managing agent should provide copies of its standard contract wordings for review.

Where the risks are located in overseas territories which are the subject of local regulation, managing agents must additionally ensure compliance with the equivalent local regulatory requirements.

## Political Risk & Credit Claims Statement of Best Practice

Following discussions between managing agents, the LMA and Lloyd's, a Statement of Best Practice has been developed for the handling of political risk and credit claims, in conjunction with the applicable Lloyd's Claims

Scheme. Lloyd's supports this Statement of Best Practice, which is consistent with Lloyd's Claims Management Principles and Minimum Standards and is appended at Appendix 1.

In any reviews of managing agents' claims handling by Lloyd's, including when assessing whether managing agents meet Lloyd's Claims Management Principles and Minimum Standards, Lloyd's will have regard to this Statement of Best Practice.

## Market Reform Contracts/Contract Certainty

### Market Reform Contract

The Franchise Board has mandated through the Underwriting Requirements (paragraph 3A) that:

- 1 Managing agents shall not permit the syndicate stamp of a syndicate managed by it to be affixed to any slip which relates to a contract or contracts of insurance unless:
  - a. the slip is in the form of the Market Reform Contract and the information contained in the slip has been properly completed in accordance with the relevant London Market Group guidance;
  - b. the slip has been marked "MR Exempt – Client Requirement"; or
  - c. the slip relates to motor business, personal lines business or term life insurance business and the slip will not be processed by Xchanging Insurance Services.
  
- 2 Managing agents shall not permit the syndicate stamp of a syndicate managed by it to be affixed to any slip which relates to a binding authority or to any line slip unless the slip has been completed in accordance with the relevant slip guidelines issued by the London Market Group.
  
- 3 Managing agents can find details of the applicable guidelines and details of the Market Reform Contract on the London Market Group website: [www.lmg.london](http://www.lmg.london) ~~www.londonmarketgroup.co.uk~~.

### Contract Certainty

The contract certainty project began in December 2004 with an FSA challenge to the UK insurance industry to end the "deal now, detail later" culture. The industry took steps to improve the way it develops and agrees contracts ensuring that the insured has greater certainty over what it has bought and the insurer greater certainty over what it has committed to. Contract certainty has brought operational improvements across the Lloyd's market and wider industry, reducing risk and improving service. Contract certainty applies to general insurance contracts either entered into by a UK regulated insurer, or arranged through a UK regulated intermediary. Contract certainty is achieved by the complete and final agreement of all terms between the insured and insurer by the time that they enter into the contract, with contract documentation provided promptly thereafter.

The Contract Certainty Code of Practice (reissued in October 2012) was produced by the Contract Certainty Steering Committee, a cross-market committee, and has been endorsed by all the UK's leading insurance

market bodies. All managing agents are expected to note and comply with the Code of Practice. Managing agents are further reminded that the Code of Practice requires that they should be able to demonstrate their performance in respect of Contract Certainty principles A & B (which set out the parties' responsibilities when entering into the contract and after entering into the contract).

The Code of Practice can be downloaded from [www.lmg.london](http://www.lmg.london) ~~www.londonmarketgroup.co.uk~~.

## Several Liability Clauses

It is of the utmost importance that all insurance and reinsurance documentation issued for or on behalf of underwriters includes an appropriate several liability clause. LMA 3333 in particular has been drafted for use by Lloyd's underwriters and is suitable for use on all contracts.

In the case of binding authority business Lloyd's has issued guidance which permits the use of alternative several liability clauses for combined certificates or where the risk is written solely by Lloyd's underwriters. This guidance is set out in [Market Bulletin Y4133](#).

The London Market Group website (~~www.londonmarketgroup.co.uk~~[www.lmg.london](http://www.lmg.london)) includes a Several Liability Decision Chart showing which several liability clause should be used in each case.

## Inception Date Allocation

Inception Date Allocation (IDA) is the market practice adopted at Lloyd's for the allocation of risks to a year of account based on the inception date of the risk in question.

The proper allocation of risks in accordance with IDA can require careful consideration of the policy in question (for example where the policy is a multi-year risk or has been written under a binding authority or line slip).

As the incorrect allocation of risks can also delay the processing of submissions, Xchanging has issued a market communication providing guidance on the proper application of IDA: 'Lloyd's Inception Date Allocation (IDA) – Reminder of How to Process through Xchanging' (Reference 2018/084).

Managing agents are encouraged to refer to the guidance provided by Xchanging to ensure the proper allocation of risks in accordance with IDA. A copy of Xchanging's guidance can be obtained from [insuranceportal.xchanging.com](http://insuranceportal.xchanging.com) (login required).

## Underwriting Stamp/Use of Lloyd's Anchor

The use of Lloyd's underwriting stamps, including the use of the Lloyd's anchor, is a part of the Lloyd's brand. Their proper use is also important in

identifying where bureau processing through Xchanging In-Sure Services Limited is required.

### **Stamps put down by syndicates/consortia/coverholders using 9000 series numbers**

#### **Stamp format**

The following requirements for the preparation and use of Lloyd's stamps have been issued by Xchanging and managing agents are asked to comply.

- 1 Stamps should not be in excess of 7.5cm wide.
- 2 Each syndicate number and its unique pseudonym should be shown. The size of typeface for each should be approximately 5mm in height.
- 3 Each stamp should bear a Lloyd's anchor symbol.
- 4 Where a syndicate number appears on a slip more than once by way of a separate stamp, an anchor symbol and a pseudonym should be shown against each syndicate number to identify it as a Lloyd's syndicate.
- 5 If a syndicate number is written on a slip the following should be inserted adjacent to the number:
  - a. the unique pseudonym
  - b. an anchor symbol
- 6 In the case of multiple stamps, a bracket is added to clarify its interpretation.
- 7 A bold horizontal line should be at the foot of the stamp to separate one syndicate stamp from the next.

### **Consortia**

There are two methods of expressing underwriters' lines for consortia as follows:

#### **Syndicate stamps**

All syndicate lines comprising a consortium should be shown individually on one stamp, this will be shown on slips by the leading underwriter of the consortium at the time of placing. This type of stamp is used where the number of syndicates involved is small and is called a 'Joint Stamp Basis'. The layout of these stamps should:

- Conform to standard requirements as detailed in the stamp format above.
- Show the title of the group at the top of the stamp.
- Show the subscribing percentage, syndicate number, pseudonym and underwriter's reference for each participating syndicate.

#### **9000 series number**

In this method the constitution of a consortium is registered at Xchanging Ins-sure Services and the leading syndicate uses a stamp on the slip to show the reference number and consortium name. This method is appropriate for consortia comprising many syndicates or where a request is made for a 'consortium number' by the underwriters.

The stamp should conform to the same standard requirements as normal syndicate stamps but will show the name of the consortium, 9000 series number and anchor symbol. The stamp should also incorporate the phrase 'All underwriters as per LPSO Registered Consortium No 9XXX' below the reference box

It is not customary to show syndicate numbers on the stamp. However, if the leading syndicate requests this it should be shown in small print.

### **Registration of 9000 series numbers**

Xchanging market communication 20014/001 dated 2 January 2014 explains the registration process for 9000 series numbers. A copy of this communication can be obtained from the Xchanging Service Centre on 0870 380 0830 or email: [service.desk@xchanging.com](mailto:service.desk@xchanging.com).

For all 9000 series stamps, whether put down by a consortium or a coverholder, Xchanging In-sure Services Limited retains a copy of the consortium or binding authority agreement, and publishes details of the lines, syndicates, and references using that number to the market on the Xchanging Knowledgebase. Enquiries should be directed to the Xchanging Service Centre.

### **Stamps put down by coverholders using 9000 series numbers**

These stamps should follow the same format as 9000 series stamps put down by consortia but must omit reference to the word consortium. This means they must incorporate the phrase 'All underwriters as per LPSO Registered No 9XXX' below the reference box

### **Stamps put down by other entities (including coverholders and services companies not writing under 9000 numbers)**

Only stamps which include the anchor symbol will be acceptable as valid on contracts which are to be processed through Xchanging Ins-sure Services.

Underwriting stamps where monies will be settled with the entity responsible for putting down the stamp should not include the anchor symbol.

Stamps put down by other entities should:

- 1 show the name of the entity responsible for putting the stamp down,
- 2 specifically identify the syndicate(s) and, where applicable, company(ies) responsible for insuring the risks on which the stamp appears (for example, '...underwriting on behalf of: 50% syndicate 123, 25% syndicate 456, 25% company ABC'),
- 3 clarify whether bureau processing is or is not required for risks upon which the stamp appears (for example, 'Premiums and claims to be settled direct with [name of entity]' or 'Premiums and claims to be settled with insurers via XIS/XCS'), and
- 4 include the Unique Market Reference (UMR) of the binding authority held by the entity responsible for putting down the stamp.

## Stamp Approval

With regard to production of new underwriting stamps, syndicates and any entities putting down stamps on their behalf will need to make arrangements with their own suppliers. The format of these stamps will, as customary, have to be approved by Xchanging Ins-sure Services. Failure to seek approval before ordering or using a stamp may delay premium signings. Enquiries should be directed to XIS Business Support via the Xchanging Service Centre on 0870 380 0830 or email: [service.desk@xchanging.com](mailto:service.desk@xchanging.com).

## Underwriting in the Room

Lloyd's ~~Property Services~~ Corporate Real Estate is responsible for the allocation of space, including allocating boxes, in the Underwriting Room (Darren Cox – email: [darren.cox@lloyds.com](mailto:darren.cox@lloyds.com); tel: 020 7327 6636). Each application will be considered in accordance with Lloyd's criteria from time to time and subject to the availability of space in the Room. In the case of new Lloyd's managing agents the allocation of space in the Room is decided with the involvement of the Lloyd's ~~Relationship Management~~ Business Development team.

All market participants underwriting in the Underwriting Room must make clear on whose behalf they are underwriting. In particular, underwriters writing in the Room on behalf of non-Lloyd's companies (or vice-versa) should ensure that it is made clear to brokers on whose behalf they are underwriting.

Where a box is allocated on a gallery for the underwriting of syndicate business, company business should not be written at the box. Where a box is allocated on a gallery on the basis that only a certain proportion of the business written will be company business, the company business written at that box should not exceed the proportion agreed. Where ~~Property Services~~ Corporate Real Estate become aware that company business is being written at a box, other than as agreed, the managing agent's allocation of the box may be removed.

Note that there is no requirement for risks to be bound in the Room. The binding of risks is governed by the laws and regulations of the applicable local jurisdiction (see [www.lloyds.com/crystal](http://www.lloyds.com/crystal)).

Firms connected with the Lloyd's market that wish to have Lloyd's passes issued to individuals employed by the firm should contact Lloyd's Corporate Real Estate ~~Property Services~~ (Trevor Smith – email: [trevor.smith@lloyds.com](mailto:trevor.smith@lloyds.com) / [lloydspassadmin@lloyds.com](mailto:lloydspassadmin@lloyds.com); tel: 020 7327 6300/6292). Passes will be allocated in accordance with Lloyd's criteria from time to time. In the case of any person who wishes to be admitted to the premises of the Society to conduct insurance business, Lloyd's requirements for the issuance of Lloyd's passes are as set out in the Annual Subscribers Byelaw.

## Recruiting Staff – Protecting Confidentiality of Third Party Information

In a number of instances, Lloyd's has taken enforcement or other regulatory action against individuals in the Lloyd's market for having taken confidential information from their employer. In a number of instances, this has arisen where an individual has sought employment elsewhere and has provided the information to the potential new employer or has intended to use the information in their new role.

While the movement of staff is a normal part of the market, nevertheless all participants have a legitimate right to expect that their confidential information will be respected and not misused. In the first instance, that means employer firms must take suitable steps to protect their own confidential information by putting in place appropriate legal safeguards, security arrangements and training for their staff. Lloyd's, however, wishes to ensure that recruiting employers in the market also play their part. Lloyd's has therefore provided guidance, which is set out in [Market Bulletin Y4950](#) and which it asks recruiting employers to follow.

Lloyd's takes very seriously any improper disclosure of confidential information. Where appropriate Lloyd's will take disciplinary action against individuals who are found to have breached confidentiality. Lloyd's may also take disciplinary action against recruiting firms if they are found to have improperly received confidential information or encouraged its disclosure. In deciding whether to bring enforcement proceedings, the Market Supervision & Review Committee at Lloyd's, which is responsible for instituting enforcement actions, has indicated that it will have regard to whether the recruiting firm followed the guidance set out in [Market Bulletin Y4950](#).

## Classes Subject to Special Approval

### War & NCBR Exposures

The uncontrolled writing of War related and NCBR perils is a material source of prudential risk for Lloyd's. The ability for exposures to aggregate means that these perils have the potential to threaten the market's financial position. Accordingly, these perils cannot be written without the prior agreement of Lloyd's. Agreement to write these perils can be obtained through the syndicate business planning process. A War and NCBR Return has been prepared for this purpose.

#### Definitions

In this section War and NCBR are defined as follows:

- **War** - includes all war related perils, including war, civil war, invasion, act of foreign enemies, hostilities (whether war be declared or not), rebellion, revolution, insurrection, military or usurped power. War related perils, however, does not include terrorism or SRCC (strikes, riots and civil commotion).
- **NCBR** - means nuclear, chemical, biological or radioactive material used as a weapon. Losses arising from the use of NCBR weapons can occur as a result of war related perils. They can also arise from criminal or terrorist acts or incidents. NCBR perils may result in direct or indirect losses.

#### When can War and NCBR risks be written?

- 1 Except as provided for in 2. below, all insurance and reinsurance policies written at Lloyd's must contain a clause or clauses excluding all losses caused by War and NCBR perils.
- 2 Coverage for War and NCBR perils can only be provided in the following circumstances:
  - a. Where exclusions for War and NCBR perils are prohibited by reason of local legal or regulatory requirements. This does not include the writing of non-compulsory War and NCBR risks, such as reinsurance of the French GAREAT pool;
  - b. The exposures fall within the exempt classes of business detailed below; or
  - c. Syndicates have Lloyd's express agreement through the business planning process.

#### Requirements for writing War and NCBR Risks

In all cases where coverage is provided for War and NCBR perils the following principles should be applied:

##### Documentation of coverage/exclusions

Where cover is to be given, the scope of cover must be clearly stated either in a separate policy or in a separately identifiable section of the policy. Managing agents should not seek to provide cover merely by omitting a suitable exclusion clause ("remaining silent") in view of the risk that a court may decide the scope of cover is wider than that intended.

The LMA has developed a number of model clauses that specifically exclude or provide for the write-back of coverage.

It is important to ensure that, where policies are specifically extended to cover War perils, the wording of the extension does not override any NCBR exclusion contained within the policy.

Where local law or regulations impose requirements on how coverage should be provided for in policy documentation it is acceptable to follow those requirements. In the exempted classes it is also acceptable to follow local market practice, although managing agents should give careful consideration to the risk that the scope of coverage provided in the policy is not clear.

### **Monitoring and control of exposure**

Managing agents are required to demonstrate that they are monitoring and controlling the exposure of their syndicates to War and NCBR perils. This includes all exposures, however written by the syndicate, including where any coverage given is only included because War and NCBR exclusions are prohibited by local legal or regulatory requirements. Exposures within exempted classes should also be included when syndicates are monitoring and controlling exposures.

Syndicates should have in place processes and procedures to monitor exposures from War and NCBR perils. These exposures should be assessed against the syndicate's risk appetite for these exposures on a regular basis.

Exposure control is reviewed by Lloyd's through the provision by managing agents of the War and NCBR Return as part of the business plan and RDS processes (see below).

### **Syndicate Business Plan agreement**

Where syndicates wish to obtain Lloyd's agreement to write War and NCBR risks they must complete the War and NCBR Return and submit it as part of the syndicate business planning process. Agreement to any plans for the writing of War and NCBR will be provided as part of the business planning process. Mid-year changes to business plans in respect of War and NCBR can be made in the usual way.

The War and NCBR Return is also reviewed as part of the RDS process to measure actual gross aggregations compared to planned gross aggregations.

Where syndicates are not providing any War or NCBR coverage or are only providing coverage in the exempted classes then there is no need to complete the War and NCBR Return.

### **Exempted classes**

Lloyd's is satisfied that in a number of classes the prudential risks do not merit the additional level of monitoring. Accordingly, the following classes of business are exempted classes and there is no requirement to provide details in the War and NCBR Return of War and NCBR coverage provided by syndicates:

- Legal Expenses (LE)
- UK Motor and Overseas Motor (M2-M6, MF, MG, MH, MI, MP)
- Casualty and Casualty treaty risk codes other than:
  - BBB/Crime (BB)
  - Workers Compensation (US and non US) (W4, W5 and W6)
  - Cyber (CY and CZ)

While managing agents do not require express agreement from Lloyd's to provide War and NCBR coverage in the exempted classes, managing agents should ensure that they comply with the requirements for writing War and NCBR risks above.

### Delegated underwriting

In the case of War on Land risks (risk code WL), authority to bind business can only be delegated to a coverholder where each risk is subject to the agreement of the leading Lloyd's underwriter prior to binding ("prior submit"). Where the level of authority delegated for WL risk code is wider than prior submit, prior agreement should be obtained from Lloyd's.

In all cases, following underwriters should ensure that there are arrangements in place to provide them with prompt advice of exposure assumed under such delegated authorities.

The underwriting of War and NCBR perils by coverholders for all other risk codes is permitted (subject to compliance with the requirements in the rest of this section).

### Civil nuclear risks

The requirements set out in this section do not apply to the underwriting of civil nuclear incidents. Most of such coverage is currently provided by insurance pools and industry mutuals, which may be reinsured by Lloyd's underwriters. This business currently forms a discrete specialist class the underwriting of which is agreed in the business plan process. Managing agents underwriting this class should nevertheless satisfy themselves that the exposure generated by participation in the pools, reinsurance of pools and industry mutuals, when aggregated with ancillary coverages such as personal accident catastrophe reinsurance of life companies, falls within their business plans.

### Financial Guarantee

Financial Guarantee risks have long been identified by Lloyd's as a class of business that can bring a high level of prudential risk to the Society if written without proper controls. Therefore, the underwriting of this class is closely monitored and restricted.

Lloyd's operates a risk-based approach to underwriting in this class and will consider proposals on their merits through the business planning process having regard to the characteristics of the business being proposed and managing agents demonstrating that they have the appropriate controls in place.

Managing agents are not required to obtain approval for the underwriting of individual contracts unless the risk falls outside the syndicate's business plan or the managing agent has been required by Lloyd's to submit individual contracts for agreement.

It is important to emphasise that this approach now operated by Lloyd's, which differs from the previous more prescriptive and rules-based approach, is not intended to signal a relaxation in Lloyd's risk appetite for the writing of this class of business, which remains limited. However, by operating a risk-based approach Lloyd's can assess each proposal individually and managing agents are not limited in the type of risks they can write by unduly rigid rules.

### **Definition**

Financial Guarantee insurance is defined as contracts of insurance (which includes any indemnity, guarantee, bond, contract of surety or other similar instrument, and references to "insurance" include reinsurance) where the insurer agrees to indemnify the insured against loss, or pay or otherwise benefit the insured in the event of any of the following:

- 1 the financial failure, default, insolvency, bankruptcy, liquidation or winding up of any person whether or not a party to the contract of insurance
- 2 the financial failure of any venture
- 3 the lack of or insufficient receipts, sales or profits of any venture
- 4 the lack of or inadequate response or support by sponsors or financial supporters
- 5 a change in levels of interest rates
- 6 a change of rates of exchange of currency
- 7 a change in the value or price of land, buildings, securities or commodities
- 8 a change in levels of financial or commodity indices
- 9 any liability or obligation under an accommodation bill or similar instrument.

In addition to risks which are coded as FG, included within Financial Guarantee are the following classes:

- Contract Frustration (Risk Code CF)
- Credit Risk (renamed from Trade Credit) (Risk Code CR)
- Mortgage Indemnity Insurance (Risk Code FM)
- Surety Bond Reinsurance (Risk Code SB)
- Salvage Guarantee Insurance (Risk Code FG)
- Seafarers Abandonment (Risk Code SA)
- Maritime Liens (Risk Code FG)

Where a managing agent is considering a risk but is uncertain as to whether it falls within the definition of Financial Guarantee insurance, the managing agent should discuss it with its SP Manager.

### **Premium Income Limits**

PMD will consider all business plans that propose to include Financial Guarantee insurance, in any of the above classes, individually. By way of general guidance, it is unlikely that business plans will be approved where the income arising amounts to more than 2% of the agreed Syndicate Business Plan GWP income, other than Credit Risk and Contract Frustration business where the relevant figure is 6% for each (in addition to income arising from other Financial Guarantee classes).

## **Credit Risk and Contract Frustration**

Within Financial Guarantee, the two largest classes written at Lloyd's are Credit Risk and Contract Frustration. These codes cover insurance that indemnify an insured, in relation to the provision of assets, goods, services and/or financing, either (1) for the non-performance of a valid contractual obligation or (2) in relation to the calling of a valid contractual bond.

In Contract Frustration, the obligor is a government entity or a commercial entity controlled and/or majority owned by a government entity(ies). In Credit Risk the obligor is a commercial entity with a majority private ownership.

It should be noted that Lloyd's is unlikely to agree business plans where any expected obligor is an individual, unless the proposed insured contracts relate to their trade, business or profession.

In agreeing to plans for Credit Risk and Contract Frustration business Lloyd's no longer expects the risks to be explicitly linked to a trade, contract or security. Instead, business plans will be considered individually.

Managing agents are reminded of Lloyd's requirements for the inclusion of NCBR exclusions in all policies (see above). In the case of Credit Risk and Contract Frustration, however, Lloyd's recognises that where the insured is a bank or other financial institution then the insured may seek to have any NCBR exclusion removed to allow the insured to take credit for the insurance for the purposes of setting regulatory capital. Lloyd's may therefore agree to the removal of NCBR exclusions in such policies as part of the business planning agreement process. Managing agents must nevertheless ensure that they comply with the requirements for reporting NCBR exposures. Syndicates must also have matching back-to-back reinsurance or the exposure must be within their net risk appetite.

## **Additional requirements for the writing of Financial Guarantee risks**

When considering proposals for the writing of any type of Financial Guarantee risks Lloyd's will expect that the managing agent can demonstrate that the following points are addressed:

### **Appropriate capability and resource**

The writing of Financial Guarantee classes requires a high level of technical expertise in the underlying risks. Where it is proposed that a syndicate will write any of the Financial Guarantee classes then Lloyd's will expect the managing agent to be able to demonstrate that it has suitable underwriting resources in place. In particular, Lloyd's will expect managing agents to have a suitably robust analytical resource to support the underwriting of any business. Managing agents should also have appropriate models in place, suitable to the types of risk being underwritten.

### **Assignment of policy**

All Financial Guarantee policies (in whichever of the risk codes listed above) must contain a condition that only allows assignment of the policy with the prior written agreement of underwriters. Where assignment of a policy does take place, the obligations placed upon the original insured by the terms of

the policy must be 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.

### **Insolvency of the Insured**

All policies must contain an exclusion in respect of any loss arising from the insolvency of the insured. In a number of territories or classes it is recognized that market practice may mean that a full exclusion is not achievable (examples of such classes include Japanese contingency, aviation contingency business, and (re)insurance of Export Credit Agencies). In such cases Lloyd's, on a request received from the managing agent (either as part of the business plan agreement process or for individual risks), may agree with the managing agent the use of clauses that do not provide a full exclusion. Lloyd's will also agree the scope of business that can be written on this basis.

### **Delegated underwriting**

Other than where delegation is to a service company coverholder, Lloyd's is unlikely to agree plans for the writing of Financial Guarantee business in any of the classes listed where the risks are bound by way of delegated underwriting. This includes, in particular, binding authorities and line slips.

### **Accelerated payments**

Where policies provide for the insured to be indemnified for the non-payment of a financial obligation by the obligor where the obligation in question involves the obligor making a payment at a future date or a number of payments over time (for example the re-payment of a loan in installments) then it will be usual for the insurance backing the obligation to pay out over time in accordance with the original payment schedule. Lloyd's may agree in appropriate cases to the inclusion of provisions for the making of accelerated payments at the sole election of the insured. As a general rule, however, underwriters should, in each case, have the opportunity to agree or decline to make the accelerated payments.

### **Fraud**

Subject to any local legal or regulatory requirements, all policies must contain a clause, or clauses, to the effect that the insurer shall have at least the remedies available under the Insurance Act 2015 in relation to fraudulent misrepresentation and fraudulent claims.

In s8/Schedule 1, the Act sets out that if a qualifying breach of the duty of fair presentation was deliberate or reckless, the insurer (a) may avoid the contract and refuse all claims, and (b) need not return any of the premium paid.

In s12 the Act sets out that if the insured makes a fraudulent claim, the insurer (a) is not liable to pay the claim, (b) the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim, and (c) in addition the insurer may by notice to the insured treat the contract as having been terminated with effect from the time of the fraudulent act.

### **Contracts of surety**

Underwriters are reminded that Lloyd's does not permit the writing of contracts of surety. Additionally, licensing restrictions apply to this class in most jurisdictions.

### **Proposals that are unlikely to be agreed**

In view of the nature of the risks involved, managing agents should note that Lloyd's is unlikely to agree plans that involve the writing of the following types of risks:

- Where the underlying risk is a tradeable instrument or a contract for difference
- Where the primary risk is price risk rather than credit risk, for example:
  - Currency fluctuation risk
  - Commodity price fluctuation risk
  - Financial market fluctuation risk
  - Property/land price fluctuation risk

~~In view of the risk that Financial Guarantee insurance creates for the market, and subject to the usual requirements for business plan approval, no managing agent may enter into a contract of Financial Guarantee insurance (as defined below in Part I) on behalf of a syndicate under its management unless either:~~

- ~~The contract falls within one of the "exempted classes" as set out below in Part II and the associated definitions set out in Part III and the principles contained in Part IV are complied with; or~~
- ~~The contract has been specifically approved by SUP.~~

~~Managing agents seeking approval to write Financial Guarantee insurance which does not fall within one of the "exempted classes" should discuss their proposals with their account executive in the SUP team as part of the business planning process. Unless agreed by Lloyd's (and except as stated in these requirements) any approval given will require the application of risk code "FG".~~

~~Where a managing agent is considering a risk but is uncertain as to whether it falls within the definition of Financial Guarantee insurance or one of the exempted classes, it should discuss it with its account executive in the SUP team.~~

### **Premium Income Limits**

~~The PMD will consider all business plans that propose to include Financial Guarantee insurance (including the exempted classes) individually. By way of general guidance it is unlikely that business plans will be approved where the income arising from the "exempted classes" amounts to more than 2% of agreed Syndicate Business Plan gross written premium income, other than Trade Credit and Contract Frustration business where the relevant figure is 5% for each (in addition to income arising from other "exempted classes").~~

### **Part I: Definition of Financial Guarantee Insurance**

Financial Guarantee insurance is defined as contracts of insurance (which includes any indemnity, guarantee, bond, contract of surety or other similar instrument, and references to "insurance" includes reinsurance) where the insurer agrees to indemnify the insured against loss or pay or otherwise benefit the insured in the event of:

- ~~1 the financial failure, default, insolvency, bankruptcy, liquidation or winding up of any person whether or not a party to the contract of insurance; or~~
- ~~2 the financial failure of any venture; or~~
- ~~3 the lack of or insufficient receipts, sales or profits of any venture; or~~
- ~~4 the lack of or inadequate response or support by sponsors or financial supporters; or~~
- ~~5 a change in levels of interest rates; or~~
- ~~6 a change of rates of exchange of currency; or~~
- ~~7 a change in the value or price of land, buildings, securities or commodities; or~~
- ~~8 a change in levels of financial or commodity indices; or~~
- ~~9 any liability or obligation under an accommodation bill or similar instrument.~~

## **Part II: Definitions of the Exempted Classes**

Terms shown in italics are defined in Part III below.

### **A. Contract Frustration (Risk Code "CF")**

- 10** Contract Frustration insurance indemnifies an insured for loss under:
- a. a specified contract or contracts for the sale, purchase, lease or delivery of assets, goods or services; or
  - b. an agreement which relates directly to the financing of such specified contract(s); or
  - c. an agreement concerning financing which is secured against assets, goods or services and/or payment for assets, goods or services due under a specified contract or contracts, or where repayment is to be effected by the sale or receipts of such goods or services, or assets, royalties or other specified receivables; or
  - d. an agreement concerning financing to a Government Entity:
    - i. whose core business is the buying and selling of commodities; or
    - ii. whose core purpose is to promote trade and/or investment as evidenced by its mandate, rating agency review or by analysis of the asset portfolio; or
    - iii. where the loan agreement stipulates the funds are to be used for trade purposes and the lender has the right to request evidence of the use of the funds.
  - e. an agreement concerning financing to a Government Entity whose specific purpose is to develop or operate infrastructure and the loan agreement stipulates the funds are to be used for this purpose; or
  - f. a co-insurance with/or reinsurance of a multilateral institution, an export credit agency or a regional trade or development organisation whose main purpose is to support trade flows or investment; or

- g. ~~a Bond or Bonds provided in accordance with the terms of a specified contract, tender document or project;~~
- 11 ~~due directly to one or more of the following perils:~~
- a. ~~a Political Force Majeure event; or~~
  - b. ~~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.~~
- 12 ~~Contracts that are permissible within section A.1 may also include Bonds which are provided in connection with eligible contracts, concession agreements and Project Finance. However, coverage for such contracts may, where appropriate, be classified under other risk codes, subject to complying with any requirements that apply to policies written in those risk codes.~~
- 13 ~~For a contract to be eligible for inclusion under A.1(c) above it must:~~
- a. ~~directly finance a specified trade contract; or~~
  - b. ~~be repaid from identified and assigned or assignable trade flows; or~~
  - c. ~~be secured upon identified collateral or assets.~~
- 14 ~~Under no circumstances should Contract Frustration policies cover:~~
- a. ~~Contracts for which the purpose is the provision of working capital or general corporate lending unless such contracts fall within the provisions of A.1 above; or~~
  - b. ~~Acquisition Finance; or~~
  - c. ~~Sovereign Lending; or~~
  - d. ~~Currency fluctuations and/or devaluations.~~
- ~~If currency inconvertibility/exchange transfer is the only Contract Frustration exposure under a Lender's Interest policy the terms of A.5 (a) & (b) do not apply.~~
- 15 ~~Insureds acting in a lending capacity may also be indemnified under Contract Frustration insurance where they are the beneficiary of a policy protecting against Lender's Interest risks in accordance with the provision set out in the definition of Lender's Interest in Part III, paragraph 7.~~
- 16 ~~Contract Frustration insurance may cover currency inconvertibility and/or exchange transfer risks when there is no specified contract of sale, purchase, lease or delivery of goods, assets or services. However such cover shall not be designed or intended to be used for the purpose of currency speculation or trading. Except where the risk is Trade Credit, any section of a policy that covers currency inconvertibility and/or exchange transfer risks shall be coded as Contract Frustration insurance.~~
- 17 ~~Where the currency of the insurance policy and the currency of the specified contract(s) are different, underwriters shall establish the mechanism by which the applicable rate of exchange to be used for the calculation of an insured loss will be determined.~~
- 18 ~~Where coverage is provided for a Political Force Majeure event, managing agents must ensure they also comply with the requirements for the writing of War and NCBR Exposures, above.~~

B. Trade Credit (Risk Code "CR")

- 19 Trade Credit insurance indemnifies an insured for loss under:
- a. a specified contract or contracts for the sale, purchase, lease or delivery of assets, goods or services; or
  - b. an agreement which relates directly to the financing of such specified contract(s); or
  - c. an agreement concerning financing which is secured against assets, goods or services and/or payment for assets, goods or services due under a specified contract or contracts, or where repayment is to be effected by the sale or receipts of such goods or services, or assets, royalties or other specified receivables; or
  - d. an agreement concerning financing to a *Commercial Organisation*:
    - i. whose core business is the buying and selling of commodities; or
    - ii. where the loan agreement stipulates the funds are to be used for trade purposes and the lender has the right to request evidence of the use of the funds; or
  - e. a co-insurance with/or reinsurance of a multilateral institution, an export credit agency or a regional trade or development organisation whose main purpose is to support trade flows or investment; or
  - f. a *Bond* or *Bonds* provided in accordance with the terms of a specified contract, tender document or project;
- due directly to the actions, inactions and/or default by a *Commercial Organisation*.
- 20 Contracts that are permissible within section B.1 may also include *Bonds* which are provided in connection with eligible contracts, concession agreements and *Project Finance*. However, coverage for such contracts may, where appropriate, be classified under other risk codes, subject to complying with any requirements that apply to policies written in those risk codes.
- 21 For a contract to be eligible for inclusion under B.1(c) above it must
- a. directly finance a specified trade contract; or
  - b. be repaid from identified and assigned or assignable trade flows; or
  - c. be secured upon identified collateral or assets.
- 22 Under no circumstances should Trade Credit policies cover:
- a. Contracts made by the insured with private individuals (other than sole traders operating in their business capacity); or
  - b. *Mortgage Finance* Insurance; or
  - c. Contracts for which the purpose is the provision of working capital or general corporate lending unless such contracts fall within the provisions of B.1 above; or
  - d. *Acquisition Finance*; or
  - e. Currency fluctuations and/or devaluations.
- 23 Where the currency of the insurance policy and the currency of the specified contract(s) are different, underwriters shall establish the mechanism by which the applicable rate of exchange to be used for the calculation of an insured loss will be determined.

Application of risk codes

Where financial default and insolvency is a covered cause of loss under policies described in section A and B above, underwriters must apply the appropriate CF and CR risk codes according to whether the obligor is considered to be public or private and give proper consideration to the

appropriate apportionment of premium in respect of any policy which covers both Contract Frustration and Trade Credit perils.

C. Mortgage Indemnity Insurance (Risk Code "FM")

Mortgage Indemnity 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 Indemnity Insurance responds if a shortfall remains between the amount of the loan and the proceeds realised from disposal of the mortgaged property following repossession.

D. Surety Bond Reinsurance (Risk Code "SB")

~~24~~ 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.

~~25~~ Lloyd's underwriters' participation in such business is limited to the reinsurance of non-Lloyd's entities which are licensed surety bond providers.

E. 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.

F. Seafarers Abandonment (Risk code "SA")

Seafarers Abandonment insurance indemnifies against the costs of repatriation of abandoned seafarers, following the insolvency of the shipowner,

G. Maritime Liens

Maritime Liens insurance indemnifies against financial losses incurred due to third party claims or costs arising directly from the insolvency or failure to pay of a charterer or prior owner of the vessel.

**Part III: Definitions of Italicised Terms used in Part II**

~~26~~ 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.

~~27~~ 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.

~~28~~ Government Entity

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

- a. a Central Government or a Ministry, Department or Agency thereof (hereinafter referred to as "Government");
- b. a Regional or Local Authority or a Department or Agency thereof (hereinafter referred to as "Local Authority");
- c. 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
- d. 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 policy.

### 29 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 Finance* or which is secured upon a commodity, asset, royalty or other specified receivable.

### 30 Project Finance

The provision of any loan or an agreement concerning financing for a specific project.

### 31 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*.

### 32 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:

- a. an expropriatory act;
- b. arbitration award default where the award is to remedy an insured expropriatory act or licence cancellation;
- c. a *Political Force Majeure* event;
- d. prevention of currency conversion and/or exchange transfer;
- e. embargo/licence cancellation;
- f. 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**

For the purposes of Contract Frustration and Trade Credit insurance as set out in sections A and B of Part II, bonds shall be defined as guarantees, including on demand bank guarantees and standby irrevocable letters of credit issued or counter-guaranteed by banks, guaranteeing the performance of specified obligations of an insured in favour of another party to whom the obligations are owed under the terms of the contract or tender to contract.

**9 Acquisition Finance**

A loan or other form of funding for the purchase of shares or other ownership interest in a company or business for which the anticipated principal method of repayment arises from the revenues and/or assets of the acquired entity.

The following do not fall within the Acquisition Finance exclusion:—

At the time of attachment of risk an acquisition regarding shares or other ownership interest in a company or business

- 1) in which the borrower owns more than 50% of the shares or other ownership interest prior to entering into the Acquisition Finance;
- 2) for which the Acquisition Finance is secured upon identified collateral, assets owned by the borrower and not forming any part of the assets of the company or business to be acquired.

**Part IV: Principles for Exempted Classes**

All policies which fall within the scope of the Contract Frustration and Trade Credit exempted classes as set out in Part II must include in the policy wording terms which meet the following requirements. Managing agents should only omit or vary terms to this effect if they have received approval to do so through the business planning process. (Note that policies written in all exempted classes remain subject to all other applicable Lloyd's requirements. This includes Lloyd's requirements for the writing of Nuclear, Biological, Chemical and Radioactive Contamination.)

**10 Assignment of Policy**

All policies must contain a condition that only allows assignment of the policy with the prior written agreement of underwriters. Where assignment of a policy does take place, the obligations placed upon the original insured by the terms of the policy must be 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.

**11 Insolvency of the Insured**

All policies must contain an exclusion in respect of any loss arising from the insolvency of the Insured.

In a number of territories or classes it is recognized that market practice may mean that a full exclusion is not achievable (examples of such classes include Japanese contingency and aviation contingency business). In such cases PMD, on a request received from the managing agent, may agree

with the managing agent the use of clauses that do not provide a full exclusion. PMD will also agree the scope of business that can be written on this basis.

#### 12 Fraud

Subject to any local legal or regulatory requirements, all policies must contain a clause, or clauses, to the effect that the insurer shall have at least the remedies available under the Insurance Act 2015 in relation to fraudulent misrepresentation and fraudulent claims.

In s8/Schedule 1, the Act sets out that if a qualifying breach of the duty of fair presentation was deliberate or reckless, the insurer (a) may avoid the contract and refuse all claims, and (b) need not return any of the premium paid.

In s12 the Act sets out that if the insured makes a fraudulent claim, the insurer (a) is not liable to pay the claim, (b) the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim, and (c) in addition the insurer may by notice to the insured treat the contract as having been terminated with effect from the time of the fraudulent act.

#### 13 Nuclear, Biological, Chemical and Radioactive Contamination

All insurance and reinsurance policies must contain a clause or clauses excluding all losses caused by NCBR perils except as provided for in the requirements for War and NCBR Exposures above.

## Construction Project Risks

The following requirements apply to construction project risks coded "CC" written within the Property D&F Specialty Other account only. The requirements are to ensure an appropriate framework exists to manage the potential risk to Lloyd's of managing agents entering into disproportionately long policies in an uncontrolled manner.

Syndicates may write non-treaty construction project risks coded CC with periods of up to 84 months (excluding maintenance periods). Policies with periods of longer than 84 months may only be bound by underwriters with prior agreement from Lloyd's. In considering any request, Lloyd's will wish to ensure that the managing agent has the appropriate controls in place.

The requirement to refer policies in excess of 84 months only applies to the initial estimated contract period and not subsequent extensions. Syndicates must have appropriate internal processes to monitor and approve contracts which are subject to extensions beyond 84 months as part of their normal control and exposure management processes.

Lloyd's continues to monitor managing agents, to ensure they have appropriate controls in place for the underwriting of construction projects, commensurate with the policy periods being written.

Managing agents should note that there are no changes to the existing Franchise Guideline requirements concerning matching reinsurance for multi-year policies.

## Unlimited Medical Expenses Cover

A number of products in the market offer policyholders coverage for medical expenses incurred when travelling abroad. In a number of cases there is no policy limit on the indemnity provided. These policies are commonly referred to as Unlimited Medical Expense Cover.

Where managing agents wish to write Unlimited Medical Expense Cover, Lloyd's requires that the following conditions are met as minimum controls to limit the prudential risk to the Society of offering coverage without a policy limit:

- Coverage must be limited to the expenses incurred by the policyholder in a 24 month period. This 24 month limit must be made clear in the course of any marketing to the policyholder.
- Coverage must be limited to expenses incurred while the policyholder is away from ~~their~~<sup>his</sup> home country. Any payments should therefore cease on the policyholder being repatriated.

Where syndicates cannot secure matching unlimited reinsurance, syndicates should provide their SP Manager~~SUP executive~~ with evidence that sufficient reinsurance is in place to indemnify the syndicate for a realistic worst-case loss scenario.

## Term Life

Lloyd's life underwriters may write non-investment term life business up to a maximum term of twenty five years. This permission is subject to the following conditions:

- 1 that managing agents advise their members underwriting life business whether the syndicate (or syndicates) in respect of which they participate, or propose to participate, intends to write business of any increased period above 10 years, whether or not up to the maximum term.
- 2 that no life syndicate shall write business that is or includes annuities without the permission of Lloyd's.
- 3 that no life syndicate shall write endowment policies without the permission of Lloyd's.
- 4 that no life syndicate shall write business that includes pensions or contracts to manage the assets of pension funds or such contracts when combined with contracts of insurance covering either conservation of capital or payment of minimum interest without the permission of Lloyd's.

## Viatical & Life Settlements/After The Event Insurance

Viatical/Life Settlements and After The Event (ATE) Insurance are two classes of insurance that have been identified by Lloyd's as posing potentially a reputational risk to Lloyd's.

Therefore, no syndicate should write these classes of insurance without prior agreement by Lloyd's. Lloyd's will require full details of the managing agent's proposals for writing these classes before approval will be given. In particular, managing agents should be able to provide the following information:

- How the managing agent will manage the potential reputational risks to Lloyd's;
- The underwriting process used to write the business, including the methodology used to price the business;
- The methodology used to reserve for the business, including controls used to manage the long-tail effects of the business;
- The process used for the handling of claims;
- The operational controls in place to manage the business.
- An explanation of the products offered; and
- Details of the experience of the underwriter and support staff.

## Retrospective Reinsurance

The writing of retrospective reinsurance includes the writing of run-off covers, stop loss policies, adverse development covers, portfolio transfers and all similar arrangements. Such policies may be written in respect of whole books of business or to cover particular risks. Their common feature is that the reinsurance provides retrospective cover, covering business that has already been written by the reinsured and where losses may already be developing. The purpose of the reinsurance is to cap or take over entirely the liabilities of the reinsured in respect of the developing losses.

Although not reinsurance, Part VII Transfers are for these purposes considered to be equivalent to retrospective reinsurance.

The Lloyd's market is primarily a market for writing live risks and prudential concerns can arise where Lloyd's syndicates write retrospective reinsurance of company market risks. The writing of retrospective reinsurance can involve taking on very large exposures in circumstances where it can be difficult to assess the underlying risks either due to poor records or other uncertainties. These issues can make it difficult for Lloyd's to assess whether syndicates have the necessary competencies to take on the business and whether the business is being appropriately priced and reserved.

Retrospective reinsurance also exposes the Central Fund to risks that were not written in the Lloyd's market.

Lloyd's does not believe that it will ordinarily be prudent to write retrospective reinsurance into the Lloyd's market. Given the concerns involved, Lloyd's considers that it is appropriate to require that any managing agent that wishes to provide retrospective reinsurance for non-

Lloyd's business should first obtain the agreement of Lloyd's for each retrospective reinsurance contract that it proposes to write.

This section does not apply to the writing of RITC or the reinsurance of portfolios in run-off within the Lloyd's market, which ~~are~~ subject to separate requirements.

## Affordable Care Act

On 23 March 2010, President Obama signed the Patient Protection & Affordable Care Act ("ACA"), which enacted a comprehensive reform of the private health insurance marketplace in all U.S states and the District of Columbia (the "Healthcare Reforms").

For insurers that may be deemed within its scope, ACA imposes a number of significant obligations including the elimination of coverage limits and the requirement of guaranteed renewability on all policies. Lloyd's wishes to ensure that all managing agents are familiar with the provisions of ACA and have given proper consideration to any business that might fall within the scope of the legislation.

At this time, managing agents should not be issuing any medical coverages to a US citizen, a US resident, or person travelling to the US unless the coverage falls within at least one of the ACA exempt categories.

Managing agents who write Accident and Health and in particular Medical Expenses or other related classes should ensure therefore that they have addressed the following points:

Managing agents should ensure that they are familiar with the ACA reforms and should avoid inadvertently providing coverage that may fall within its scope. In particular, managing agents should be sensitive to the potential for accident and health coverages and stop-loss with low attachment points to be classified as health insurance.

Underwriters must ensure that they are taking a cautious approach when relying on exemptions from ACA. Where there is any doubt they should consult with Lloyd's, including the Lloyd's International Trading Advice (LITA) team and, where appropriate, obtain suitable legal advice.

Managing agents should ensure a disclaimer is placed on any medical policy issued that is likely to cover US resident insureds or non-US persons traveling within the US which states that the coverage does not provide the minimum essential coverage and other market reforms required by ACA. The purpose of the disclaimer is informational only and will not affect whether a particular coverage is subject to ACA. Therefore, the use of a disclaimer is not a substitute for a proper assessment of the application of ACA to the product in question. A recommended wording and additional information on the use of disclaimers is included on Crystal.

~~Though now in effect, the~~ regulatory landscape relating to ACA is continuing to evolve. ~~The interpretation of ACA provisions in a number of respects remains unclear and guidance continues to be issued.~~ Managing agents will therefore need to monitor developments.

For more information managing agents should visit Crystal ([www.lloyds.com/crystal](http://www.lloyds.com/crystal)) or contact LITA.

## US and Canadian Cannabis-Marijuana Risks

The guidance in this section applies to cannabis related business in the US and Canada only. The writing of such business outside of the US and Canada will require managing agents to consider the application of the laws and regulations as they apply in the relevant territory.

### **US Cannabis and Hemp Risks**

#### **Cannabis Risks**

Currently, ~~cannabis marijuana~~ is listed as a Schedule 1 drug under US federal Controlled Substances Act, which means that it is not legal for sale. In addition, cash generated from the sale of ~~cannabis marijuana~~ may implicate federal Anti-Money Laundering laws. Nevertheless, a number of states have passed laws that permit the sale of ~~cannabis marijuana~~ for medicinal purposes and additionally a smaller number allow its sale for recreational purposes.

Based upon a thorough review of all positions, unless and until the sale of either medicinal or recreational ~~cannabis marijuana~~ is formally recognized by the Federal government as legal (as opposed to subject to non-enforcement directives), underwriters should not insure such operations in any form (including crop, property, or liability cover for those who grow, distribute or sell any form of ~~cannabis marijuana~~ or cover for the provision of banking or related services to these operations) in the United States.

Coverage may be provided to non-~~cannabis marijuana~~-related businesses with incidental ~~cannabis marijuana~~ exposures (e.g. a pharmacy or physician where a small amount of their business may include ~~cannabis marijuana~~ products or prescriptions) although, losses arising from such exposures should, where possible, be excluded from cover~~if losses arising from such exposures are expressly excluded from cover.~~

Lloyd's will continue to monitor developments under US law and will reconsider this position if and when the conflict of laws is resolved.

#### **Hemp Risks**

The Agricultural Improvement Act of 2018 (the 'Act') – popularly known as the 'Farm Bill' – among other matters legalises industrial hemp. The Act reclassifies hemp to distinguish it from cannabis, affirms the legitimacy of hemp research, and establishes a framework for state and federal regulation of hemp production.

Section 10113 of the Act amends section 297A of the US Agricultural Marketing Act of 1946 to define 'hemp' as:

*"the plant Cannabis sativa L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis."*

Section 12619 of the Act amends the US Controlled Substances Act (CSA) to exclude hemp – as defined above under the Agricultural Marketing Act – from the definition of cannabis. In addition, the section excludes tetrahydrocannabinols (THC) found in hemp from the listing of THC in Schedule I of the CSA.

Hemp is legal within the US and may be underwritten at Lloyd's. Syndicates underwriting US hemp related risks should be mindful, however, that the Act's relaxation of federal law does not equate to a complete deregulation of hemp. Further, some states' laws may be more restrictive than the federal CSA. Underwriters should therefore take steps to remain informed of the development of regulations in this area and ensure that any risks written conform to state and federal laws - this would include verifying that any applicable state or federal regulatory approvals have been acquired.

The guidance applies to marijuana related business in the US only. The writing of such business outside of the US will require managing agents to consider the application of the laws and regulations as they apply in the relevant territory.

### **Canadian Cannabis Risks**

The Canadian Cannabis Act makes it legal in Canada to produce, distribute, sell and possess cannabis, subject to compliance with the provisions of that Act. Lloyd's is satisfied that, if properly done, Lloyd's underwriters are well positioned to write Canadian cannabis business subject to compliance with local Canadian requirements.

However, as cannabis remains a Class B drug in the UK, Lloyd's has considered whether Part 7 of the Proceeds of Crime Act 2002 (POCA) is engaged by underwriters providing insurance cover in Canada. In particular, it is recognised by Lloyd's that by reason of a combination of section 328(3), 329(2) and 340 POCA, sections 4, 6, and 37 Misuse of Drugs Act 1971, the production etc. of cannabis in Canada could be said to be "*proscribed conduct*" under POCA. This raises the question whether providing cannabis related insurance could result in an offence under section 328 POCA, notwithstanding that the underlying risks have been legalised in Canada.

Having taken advice from specialist Leading and Junior Counsel, Lloyd's is satisfied that:

- Providing insurance for Canadian cannabis risks would not amount, in the circumstances under consideration, to entering into, or becoming concerned in, an arrangement which facilitates the acquisition, retention, use or control of criminal property by another person thereby breaching section 328 POCA.
- That neither POCA – nor any of its statutory predecessors – was designed to bring wholly lawful conduct such as the provision of insurance of business activity carefully legalised in another country, into its scope.
- This view is consistent with the Explanatory Notes to POCA, including for example paragraph 6 which states that the statute's purpose was to criminalise money laundering in its broadest form which "is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin so that they can be retained permanently or recycled into further criminal enterprises" – this is far removed from

Lloyd's underwriters openly and properly providing businesses in Canada with insurance against a conventionally covered ascertainable external event.

Lloyd's will therefore consider the writing of Canadian cannabis business by syndicates at Lloyd's as part of the usual business planning process. Managing agents will, however, be required to demonstrate an appropriate understanding of the Canadian Cannabis Act to ensure compliance with all local laws. Where necessary, and should there be any question as to the legality of accepting any particular risk, either under UK or Canadian laws, managing agents will be required to obtain appropriate legal advice.

Particularly in view of the proximity of the USA to Canada and the potential to write cross-border exposures, it is important that managing agents ensure that any cannabis risks have Canadian risk location only.

## Tax & Wealth Strategy Schemes

Lloyd's is aware of the insurance of taxation risks in numerous forms, typically within the following:

- 1 a M&A transaction where a Warranty & Indemnity policy insures the buyer or seller of a business against the risk of an unexpected and unknown tax liability (which may be in the form of a breach of a tax warranty or a claim under a tax indemnity);
- 2 a M&A transaction where a Warranty & Indemnity or tax specific policy insures a buyer or seller of a business against the risk of an identified tax liability crystallising in the future (identified usually meaning identified by professional advisers during the course of due diligence and, due to the deal dynamics, the parties decide to insure that risk); and
- 3 an identified tax issue which does not arise from an M&A transaction, where a standalone tax specific policy insures the tax risk identified. These can also be useful risk transfer tools for a variety of transactions including a restructuring, a refinancing, to protect a liquidator, a trustee or a guarantor. Policies may also provide insurance against the set-up costs, defence costs, interest or penalties arising from a tax liability.

### **DOTAS legislation, 'Enablers' legislation and reputation risk to Lloyd's**

In all of the above, in addition to any other relevant considerations that may apply, managing agents must have regard to the following three key areas:

- 1 The Disclosure of Tax Avoidance Schemes (including the VAT Disclosure of Tax Avoidance Schemes and the legislation in Part 7, Finance Act 2004) (otherwise known as "DOTAS").
- 2 The "Enablers" legislation (introduced in the Finance Act (No. 2) 2017).
- 3 Abusive tax avoidance which, if insured, could bring reputational harm for Lloyd's.

(Note that, while (1) and (2) refers to the relevant UK legislation, other jurisdictions increasingly have equivalent regimes in place which need to be taken into account in the same way.)

### **Lloyd's expectations of managing agents**

Taking each of these in turn, Lloyd's position is as follows.

#### **DOTAS**

In view of the legal and reputational risks that arise Lloyd's requires that managing agents do not provide any insurance protection for (i) the tax at risk under a DOTAS arrangement; (ii) any set-up costs involved in establishing/operating a DOTAS scheme; (iii) any costs in defending any challenge by HMRC; or (iv) any adverse penalty or interest charges in the event the DOTAS arrangement is successfully challenged by HMRC. This also applies in relation to equivalent regimes that operate in other jurisdictions (including, but not limited to, the Tax Shelter regime in the US Internal Revenue Code).

#### **The Enablers legislation**

In its continued attempt to counteract what is perceived as aggressive tax avoidance, the UK government introduced the "Enablers" legislation in the Finance (No. 2) Act 2017. This legislation is designed to penalise those persons who obtain a financial return by enabling tax avoidance even though they are not the taxpayer primarily benefiting from the tax avoidance. Managing agents must therefore be aware of the Enablers legislation when seeking to provide insurance in any area where a syndicate could insure an enabler of tax avoidance. Failure to have proper regard risks the managing agents also becoming an enabler for the purposes of the legislation. Similar considerations will also apply in other jurisdictions.

#### **Reputation**

The UK and other governments continue to exercise concerted efforts to counter what they regard as "abusive" tax avoidance. One example would include an abuse of the legislation entitling tax payers to tax credits/savings. The 'abuse' could be certain taxpayers entering into non-commercial arrangements motivated purely by receiving such credits/savings when they would not be entitled to receive the credits/savings but for the non-commercial arrangements.

This is a topic which of course evolves as tax rules change and the courts decide on what constitutes unacceptable or acceptable tax avoidance. Lloyd's requires that, notwithstanding the specific DOTAS and Enablers comments above, managing agents give careful consideration to and refrain from writing any insurance policy which could put at risk the reputation of Lloyd's by virtue of that policy facilitating aggressive tax avoidance, whether in the UK or abroad.

When considering whether an arrangement does create a reputational risk, managing agents should consider all relevant factors. This would include considering whether disclosure could be required under the EU's mandatory disclosure regime, as set out in Council Directive 2018/822/EU (and commonly referred to as DAC 6). Such disclosure does not, of itself, mean there is aggressive tax avoidance but where there the arrangement is of the

type that disclosure may be required managing agents must consider whether there is, and if so must not facilitate, aggressive tax avoidance.

**Note:** this guidance is limited to the underwriting of taxation risks. Lloyd's has separately provided information to the market on the Criminal Finances Act 2017, which came into effect on 30 September 2017. This introduced two new corporate offences of failure to prevent the facilitation of UK and foreign tax evasion. For further details, see Market Bulletin Y5117.

Syndicates wishing to insure certain tax or "wealth strategy" schemes are required to consult first with SUP.

Under these schemes, syndicates may insure participants against adverse court or fiscal authority findings that they owe additional tax. They may also insure the scheme's provider against professional indemnity and other professional risks.

Whilst we acknowledge that such schemes can be properly operated (and that syndicates may insure those schemes) such schemes, especially if used aggressively, could pose adverse reputational issues for the managing agent and for the Lloyd's market.

Therefore, managing agents must ensure that they consult in advance with SUP where they propose insuring any scheme (or the scheme's operator) where the scheme may have or share any of the following characteristics:

- Advertise of offer advantages to participants of savings in income tax
- Participants identified as "contractors"
- Payment by participants (or "contractors") of salary earned from outside sources into trusts or other accounts connected to the scheme, intended to repay or loan a percentage of the salary to the participants
- Advertisements connected to the scheme inferring that the services offered are not tax avoidance or are compliant with the requirements of tax regulatory authorities

The managing agent should also ensure that any proposal for it to insure such scheme has been approved by the agent's Board or Risk Committee.

## Cryptocurrencies, decentralised digitised assets and related transactions

As cryptocurrencies and other crypto assets are becoming more widespread and acceptable in the commercial world, the insurance market is receiving an increasing number of requests for either specific policies to provide related coverage or amendments to traditional lines in order to provide or clarify coverage.

At present, cryptocurrencies and other crypto assets remain in the early stages of development and acceptance. In some cases, the use of cryptocurrencies has also resulted in negative media publicity through their association with criminal activity (for example, in the theft of crypto coins or in their use to support the criminal activity).

In view of their novel nature and the absence of clear regulatory frameworks and precedents for cryptocurrencies and other crypto assets, Lloyd's

considers that managing agents should proceed with a level of caution that recognises the risks associated with this class of asset. Where syndicates are to provide coverage in relation to these assets or businesses associated with them, Lloyd's will wish to ensure that managing agents have the required expertise in the underlying risks.

In addition to underwriting considerations, when providing coverage in this class, managing agents also need to have particular regard to the increased risk of financial crime, particularly anti-money laundering and sanctions risks as discussed below. Although not exhaustive, Specie, BBB/Crime, Cyber, PI, D&O and Casualty Treaty are considered among the most exposed lines of business to financial crime risk.

## **Lloyd's expectations of managing agents**

### **Underwriting considerations**

Regardless of whether bespoke policies are created or traditional lines of business are amended to recognise and afford coverage for cryptocurrencies and other crypto assets, syndicates wishing to provide such cover must ensure that they are able to fully evaluate all of the relevant exposures, including consideration of any systemic exposures. These should include considerations relating to matters such as:

- Security of private keys, including ensuring that confidentiality of this information is maintained and whether coverage is provided for "cold" and "hot" storage
- The integrity of the code standing behind the insured risk and how matters such as subsequent code updates change the risk profile
- Cyber-crime, hacking risk and underlying network issues that may impact on the insured risk, including technological failure, malicious (or even unintentional) attacks, forks and loss of interest in a particular blockchain leading to failure to maintain the continued processing of transactions
- The identity of the insured and the scope of coverage in the context of any transaction involving decentralised and/or anonymous actors
- The insurability of risks and assets in compliance with applicable financial services laws, given the rapidly changing regulatory framework in this area
- Exchange rate volatility and exposure to any fluctuations in the value of any underlying crypto asset.

In this regard, a key challenge for insurers is that the underlying technologies for crypto assets are immature and still changing. Managing agents should therefore ensure they understand the implications of developments and changes in such technologies.

Managing agents must also satisfy themselves that policies are compliant with any applicable laws and regulations relating to the insurability of crypto assets at the inception of a policy, during the coverage period, and in the event a policy pays out to an insured.

Policies must only be issued in legal tender (or "fiat currency") with fixed policy limits for the policy term which are unable to be altered by any crypto asset factor, including any exchange rate variation in underlying crypto assets. In respect of a loss, there must be a clearly defined method of valuation clause included in the wording which should include where appropriate an objective mechanism of calculating any relevant exchange

rate between fiat currencies and the crypto assets. Payment for coverage should only be made in fiat currency.

Managing agents should note that the following risks must be referred to Lloyd's for prior approval:

- Any products to be offered to consumer customers
- Any risks to be written via delegated authority

### **Financial Crime considerations**

Cryptocurrencies and crypto assets are sometimes associated with supporting criminal activities such as tax evasion, money laundering, contraband (illicit goods) transactions, extortion and circumvention of international financial sanctions. The risk for financial crime in transactions involving crypto assets is therefore high and will need to be considered by managing agents when assessing proposals.

In view of the additional compliance risks associated with this class, if managing agents decide to provide cover associated with cryptocurrencies and crypto assets or businesses associated with them, which would include associated transactional risks such as ICOs, Lloyd's expects managing agents to be able to provide appropriate assurances that their own anti-financial crime framework is adequate and proportionate to the risk.

Furthermore, managing agents are expected, where appropriate, to understand and be satisfied that the insured has proportionate anti-financial crime systems and controls in place. This would include ensuring that potential insureds are carrying out effective checks in relation to Know Your Client (KYC), Anti-Money Laundering (AML), source of funds enquiries and, where applicable, OFAC requirements on their own clients and those who may be participating in fundraisings and other transactions.

In addition to the immediate financial crime risks of providing cover to arrangements that may have some association with criminal activity, managing agents need also to have careful regard to the reputational risks to Lloyd's associated with insuring illegitimate activities associated with these assets. This includes the risk that purchasers of insurance from Lloyd's may use their association with Lloyd's to provide legitimacy to an arrangement.

Depending upon the line of business being written, it is important that managing agents obtain and keep on record copies of supporting documentation from insureds, for example:

- Regulatory authorisation(s) and permission(s)
- Policies and procedures
- Evidence of advice sought from professional advisers
- Audit reports
- Banking agreements
- Outsourced service agreements

## Political Risk & Credit Claims Statement of Best Practice

## Appendix 1

Applicable to PR, CF and CR risk codes

The Lloyd's leader must ensure that other Lloyd's agreement parties are involved in decision making and the following market are kept informed

	Situation	Action (CF, CR risk codes)	Action (PR risk code including CEND & aircraft repo)
1	The insured notifies of a possible claim or circumstance that may give rise to a claim	<ul style="list-style-type: none"> <li>Monitor</li> <li>Ensure any other Lloyd's agreement parties and followers are advised</li> <li>In the event of insolvency advice is to be immediate</li> </ul>	<ul style="list-style-type: none"> <li>Monitor</li> <li>Ensure any other Lloyd's agreement parties and followers are advised</li> <li>In the event of CEND advice is to be immediate</li> </ul>
2	Waiting Period is triggered	<ul style="list-style-type: none"> <li>Monitor</li> <li>Ensure any other Lloyd's agreement parties and followers are advised</li> <li>Where Waiting Period is less than 180 days, advice is to be immediate</li> </ul>	<ul style="list-style-type: none"> <li>Monitor</li> <li>Ensure any other Lloyd's agreement parties and followers are advised</li> <li>Where Waiting Period is less than 180 days, advice is to be immediate</li> </ul>
	Waiting Period is less than 180 days, or 180 days or more but 50% eroded	<ul style="list-style-type: none"> <li>Claim agreement parties (CAP) to determine coverage and communicate reserving and recovery strategy to followers</li> <li>Include Loss Adjuster, Legal Team, Recovery Agent as applicable</li> </ul>	<ul style="list-style-type: none"> <li>Claim agreement parties (CAP) to determine coverage and communicate reserving and recovery strategy to followers</li> <li>Include Loss Adjuster, Legal Team, Recovery Agent as applicable</li> </ul>
3	Recovery prospects	<ul style="list-style-type: none"> <li>Determine recovery strategy at the time of reserving if possible</li> </ul>	<ul style="list-style-type: none"> <li>Determine recovery strategy when reserving</li> </ul>
4	Waiting Period expired and claim validated	<ul style="list-style-type: none"> <li>Pay &amp; initiate recovery procedure</li> <li>Provide regular updates to the following market unless and until recoveries are exhausted</li> </ul>	<ul style="list-style-type: none"> <li>Pay &amp; initiate recovery procedure</li> <li>Provide regular updates to the following market unless and until recoveries are exhausted</li> </ul>