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LOCATION:	86/G12
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DATE:	8 August 2000
REFERENCE:	Y2358
SUBJECT:	CANADIAN TRUST FUND AND TRADING ARRANGEMENTS

1. Purpose

The purpose of this Bulletin is to outline the main features of the heads of agreement recently concluded between the Office of the Superintendent of Financial Institutions Canada (OSFI) and Lloyd's relating to underwriters trading in Canada. The agreement is intended to become effective from 1 January 2001 for the Lloyd's Canadian return for 2000, due to be filed with OSFI by the end of February 2001.

This Bulletin is intended as a summary of the new arrangements contemplated by the heads of agreement, and detailed information will be distributed prior to their inception. It should be noted that OSFI and Lloyd's are in further discussions regarding implementation, and that there might be some changes to what is outlined below.

2. Background

In August 1998, OSFI and Lloyd's formed a working committee to address several issues relating to Lloyd's regulatory compliance arrangements in Canada. The heads of agreement incorporate the committee's recommendations and commit both parties to work together to implement them for Lloyd's Canadian filing for 2000, due to be filed with the regulator by the end of February 2001.

Under the current compliance arrangements:

- Lloyd's files a quarterly solvency return to OSFI;

- the return is prepared by the Attorney in Fact for Canada using Canadian accounting and actuarial principles and data relating to Canadian business reported to his office;

- the return reports aggregate Lloyd's market liabilities for Canadian regulated business, calculated by the Lloyd's Canadian actuary;

- regulated business is defined as Canadian situs business, excluding "wet" marine, written in any currency;

- the aggregate of the Lloyd's Canadian Trust Fund (LCTF – a currency-based fund) is included in the return as the assets supporting these liabilities. Assets are required to be in excess of liabilities by a percentage determined by OSFI;

- additional funds have had to be placed into the LCTF on a number of occasions over the last two years to meet these solvency requirements.

3. New arrangements

Under the new arrangements:

- Lloyd's will include information on outstanding liabilities for each open syndicate year of account in its quarterly filing;

- the applicable accounting and auditing standards will be the UK standards applicable to Lloyd's. Some adjustment to liabilities may be made to reflect material differences between these and Canadian standards;

- estimates of gross outstanding liabilities for each syndicate year of account will be calculated centrally using:

    - Canadian regulated business data drawn from LPSO, LCO and the Canadian Attorney's Office (for Scheme Canada);

    - actuarial factors determined by Lloyd's and its Canadian actuary in collaboration with OSFI. This process will be similar to that used for Australian and South African business.

- admissible reinsurance recoverables reported by Managing Agents may be credited against these liabilities to provide net syndicate year of account liabilities;

- assets equating to a percentage of the resulting net liabilities will be required to be held in the LCTF. The LCTF will continue to be a working Fund held severally at Member level. Agents will be responsible for ensuring that the Members on a particular syndicate year of account hold sufficient assets to cover the solvency requirement in respect of their liabilities for that year of account;

- to facilitate these arrangements, the Lloyd's Canadian Trust Deed will be amended with a new definition of Canadian business, based on regulated business not currency. The

Council will make ancillary requirements for the minimum levels of funding necessary to comply with OSFI requirements;

- there will be a “floor” in the LCTF providing that assets cannot fall below a percentage of the previous quarter’s required level without OSFI approval. Instructions on how this requirement is to be met will be promulgated;

- Managing Agents will be able to withdraw assets surplus to the funding requirements from the LCTF to syndicate PTFs on a quarterly basis, subject to the floor;

- a mutualised Margin Fund will be created to hold assets representing an additional solvency margin on all open 1993 and post years of account. This will be similar to the Lloyd’s Joint Asset Funds in other jurisdictions.

4. Implications

The principal implications of the new arrangements are as follows:

- ***Funding requirements*** **–** Because of different business definitions, actuarial principles and solvency formulae, it is difficult to quantify the effect of the new arrangements at this stage. Preliminary indications (using 1999 year-end data) are that the total funding requirement under the new arrangements would have been of the same order of magnitude as the actual requirement at 31 December 1999 had the former been in force at that time. However, it is likely that the requirement per syndicate would have been different.

- ***Funding timetable*** **–** Lloyd’s is required to file with OSFI 45 days after a quarter end and 60 days after a year end. Any funding shortfall has to be made good within 30 days of the filing date.

- ***Trust Deeds*** **–** the Lloyd’s Canadian Trust Deed will be amended and a new Margin Fund Deed will be produced. It is intended to bring the former into line with the provisions of the Premiums Trust Deed, in as far as these are acceptable to OSFI.

- ***Canadian business definition*** **–** Market Bulletin Y2177 dated 25 November 1999 outlined the new definition of Canadian business and revision to LPSO processing and coding procedures. These procedures have been in force throughout 2000.

- ***Non Canadian currency Canadian situs business*** **–** premiums relating to this will fall within the LCTF definition of Canadian business and will be routed to that Fund. Market Finance will be issuing guidelines on how these premiums will be held and invested if not converted to Canadian currency.

- ***Non-regulated Canadian dollar business*** **–** premiums relating to Canadian dollar denominated business falling outside the situs/non-marine definition will no longer form part of the LCTF. Market Finance will be issuing guidelines on how these premiums are to be held and invested.

- ***Withdrawal of surplus assets from the LCTF* –** Agents will be permitted to withdraw assets surplus to funding requirements from the LCTF on a quarterly basis, subject to the "floor" provisions mentioned above.

- ***Canadian Margin Fund* –** Margin Fund assets will be held on a joint basis. Collections will be made on the basis of quarterly syndicate year of account liabilities and will include re-apportionment as the total funding requirement and individual syndicate shares change by quarter.

- ***Reporting* –** further details with be advised by the Market Reporting and Solvency Department in due course.

- ***Ceded reinsurance* –** OSFI regulations on the crediting of reinsurance for solvency purposes are restrictive. Credit will be permitted for any reinsurance recoverables on unpaid claims where the contract was placed with a reinsurer regulated by OSFI or accredited by a Canadian province. Contracts placed with non-Canadian branches or offices of reinsurers falling into each of these categories would be deemed to be admissible. As noted above, it would be for Agents to identify any such reinsurance on unpaid claims.

  Given these restrictions and difficulties of apportionment, reinsurance recoveries in respect of 1993 and post Canadian business will be payable into syndicate PTFs rather than into the LCTF.

- ***Investment* –** investment of assets in the LCTF and Margin Fund will be in accordance with Lloyd's investment guidelines and OSFI regulations. Further details will be promulgated by Market Finance.

- ***Taxes* –** Taxation Department will publish further information on the taxation treatment of US dollar Canadian business and interest on investments in respect of Canadian business held outside the LCTF.

5. Summary

The introduction of the new arrangements outlined above achieves a solution to several issues which have remained outstanding between OSFI and Lloyd's for a number of years. From the Lloyd's perspective:

- the new arrangements will provide the market with a greater degree of clarity as to the costs of trading in Canada;

- they will also provide increased certainty as to its Canadian solvency funding requirements;

- funding requirements will also be more equitable between syndicates;

- it will be easier to reconcile funding requirements with syndicate's own records of business.

Further questions can be directed to:

- Stuart Loveless – North America Unit (general OSFI issues)
  Lloyd’s extension 6234

- Leslie Rosenberg – MRSD (solvency and reporting issues)
  Lloyd’s extension 5490

- Susan Mackenzie – Legal Services (trust deeds)
  Lloyd’s extension 6361

- Mike Fitzgerald – Market Finance (investment and trust fund operations)
  Lloyd’s extension 5901

- Susan Blackman – LPSO (processing issues)
  Lloyd’s extension 5799

- Maureen McLeod – Taxation Department (tax issues)
  Lloyd’s extension 6860

- North America Information Services Centre (all other issues)
  Lloyd’s extension 6677

This bulletin is being sent to the compliance officer of all Managing Agents, Active Underwriters and, for information, recognised accountants.