

FROM: Manager, Settlement and Trust Fund Operations
LOCATION: CH/L4
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SUBJECT: LETTER OF CREDIT FACILITY FOR THE
LLOYD'S DOLLAR TRUST FUNDS

ATTACHMENTS: None
ACTION POINTS: None
DEADLINE: None

For a number of years Lloyd's and Citibank have been operating the Letter of Credit facility for the Lloyd's Dollar Trust Fund, for a syndicate to participate in this facility they must first have signed the relevant legal documentation between themselves and Citibank. Many syndicates signed up to the scheme when it was first introduced, but due to reduced awareness of the scheme there have been occasions when a letter of credit has been delayed because the documentation has not been signed by all the syndicates on the risk.

The purpose of this bulletin is to raise awareness of the scheme and to ask that if you do not currently participate in it that you review your requirements and contact Keith Coutinho on Lloyd's ext. 5762 if you feel that you would like to participate in the scheme. If you are unsure whether you are currently able to participate in the scheme please contact Donna Caddy on Lloyd's ext. 2693.

Attached is a description of the facility and the documentation required if you are not already participating.

FACILITY SUMMARY

1.0 Introduction

- 1.1 Lloyd's Market Board approved the introduction of a Citibank uncommitted and secured Letter of Credit facility for the Lloyd's Dollar Trust Funds (LDTFs) as negotiated by Settlement and Trust Fund Operations (STFO).
- 1.2 This facility will primarily provide a co-ordinated approach to the issuance of a Letter of Credit in respect of a single Lloyd's policy issued on behalf of multiple syndicates.
- 1.3 This facility is only to be utilised for the provision of Letters of Credit for the purposes described below where they are processed centrally. Managing Agents are, of course, at liberty to negotiate the terms of bilateral Letter of Credit facilities with any bank.

2.0 Letter of Credit (LOC) usage

2.1 Reasons for usage

2.1.1 A Lloyd's syndicate that has established a Credit for Reinsurance Trust Deed and gross funds the trust account in accordance with the standards agreed with the NYID continues to be an accredited reinsurer for business in all states. However, syndicates are required to use a LOC or funds withheld arrangement in respect of life business.

2.1.2 A LOC may be appropriate for the following reasons:

- (i) to enable syndicates to reduce the funding requirements in their Credit for Reinsurance Trust Fund (CRTF) by posting a LOC directly with the cedent, so avoiding funding the liability on a gross basis;
- (ii) providing a LOC to the Surplus Lines Trustee on a bi-lateral basis as an admitted asset;
- (iii) providing a LOC to the Credit for Reinsurance Trustee on a bi-lateral basis as an admitted asset;
- (iv) a fast payment mechanism; and
- (v) as a deposit for US judicial purposes.

2.2 Reminder to underwriters and agents

2.2.1 Given that LOCs are a relatively expensive instrument and that, in general, there is no regulatory requirement to post LOCs as Lloyd's is an accredited reinsurer (see 2.1), LOCs should only be used where there are specific risk or funding reasons.

2.2.2 There is currently a US\$ 400 million ceiling on the value of LOCs available to the Lloyd's market under this facility. Use of LOCs should therefore be limited to those situations where an LOC is essential.

2.2.3 A LOC issued in favour of a surplus lines policyholder will not avoid the necessity to place funds in the Surplus Lines Trust Fund (SLTF); a LOC issued to a surplus lines policyholder will mean the liability is therefore double funded.

2.3 LOCs issued to US cedents

2.3.1 The Credit for Reinsurance Trust Fund (CRTF) permits syndicates to provide security to a cedent "by means other than the Trust Fund" with the agreement of that cedent. LOCs are one way in which security can be provided outside the trust.

2.3.2 The consequence of issuing a LOC to a cedent is that the cedent no longer qualifies as a beneficiary under the CRTF and the syndicate is therefore not obliged to fund the CRTF for that liability. However, the syndicate will have to provide collateral to Citibank which matches the amount of the LOC.

2.3.3 LOCs can therefore be issued to U.S. cedents in lieu of funding the liabilities in the U.S. Reinsurance Trust Fund. As a general rule, the LOC issued must conform to the regulatory requirements of the cedent's domiciliary/licensure state(s) to ensure that the cedent may take credit on its annual statement for reinsurance placed with syndicates. Therefore, the cedent, or the cedent's agent, should dictate the requisite LOC form to be used.

2.3.4 The LOC must be issued before the "as of" date of the annual financial statement filed by the U.S. cedent.

2.4 LOCs for the Surplus Lines Trust Fund

2.4.1 Syndicates may deposit LOCs into the SLTF as an asset. LOCs for this purpose can only be issued using this facility if the security to be provided by a syndicate is cash. The beneficiary of such an LOC must be Citibank in their capacity as trustee of the SLTF.

2.4.2 To serve as an asset in the SLTF for liabilities calculated in a particular calendar quarter, the LOC must be effective and must be in place on the last day of the calendar quarter for which the quarterly/annual report was filed with the New York Department of Insurance.

2.4.3 Please note that the quarterly reports are due forty five (45) days after the close of each calendar quarter. The annual report is due sixty (60) days after the year-end.

2.5 LOCs for the Credit for Reinsurance Trust Fund

2.4.1 Syndicates may deposit LOCs into the CRTF as an asset. LOCs for this purpose can only be issued using this facility if the security to be provided by a syndicate is cash. The beneficiary of such an LOC must be Citibank in their capacity as trustee of the CRTF.

2.4.2 To serve as an asset in the CRTF for liabilities calculated in a particular calendar quarter, the LOC must be effective and must be in place on the last day of the calendar quarter for which the quarterly/annual report was filed with the New York Department of Insurance.

2.4.3 Please note that the quarterly reports are due forty five (45) days after the close of each calendar quarter. The annual report is due sixty (60) days after the year-end.

3.0 The Citibank Letter of Credit "Scheme"

3.1 The Citibank Letter of Credit facility together with the central processing of STFO and Xchanging Claims Services (XCS) (*the Scheme*) will provide LOCs to syndicates to cover obligations resulting from new U.S. business incepted since 1st August 1995, i.e. for the LDTFs.

3.2 The Scheme will cover the provision of one LOC to a beneficiary on behalf of one or a number of syndicates, where each syndicate is severally liable for their individual participation in each LOC.

3.3 STFO and XCS have an established system under the Lloyd's American Trust Fund (LATF) LOC facility for processing and monitoring multiple syndicate LOCs which was extended and amended to cover the LDTFs.

3.4 The Scheme will also cover cash secured LOCs issued to Citibank as trustee of the Surplus Lines Trust Fund (SLTF). Syndicates wishing to issue a LOC in to the SLTF should contact Citibank direct.

4.0 Operation of the facility

4.1 Issuance

4.1.1 With regard to 4.1.2. below, a LOC will be issued subject to:

- (i) satisfactory documentation having been completed by that syndicate;
- (ii) sufficient collateral being available in that syndicate's LDTF accounts.

Should a syndicate not have completed the relevant documentation (see

Section 6) and/or not possess sufficient funds to provide the collateral for its participation in the LOC, Settlement and Trust Fund Operations (STFO) will either retain the transaction until all syndicates have signed the documentation/have sufficient funds or it will initiate a "partial" issuance on behalf of the funded syndicates. STFO/XCS will liaise with the syndicate and the broker to decide on the appropriate course of action.

4.1.2 This facility is uncommitted and therefore Citibank has the right to turn down any application for an LOC by a syndicate. Where such application is in respect of a multiple-syndicate LOC, the LOC may be issued without that syndicate on a "partial" basis on agreement with the broker/beneficiary.

4.1.3 LOCs will be established for single contracts on a single year of account basis.

4.3 Term

4.3.1 LOCs will normally only be issued for a 12 month period. However, if requested, Citibank will issue LOCs on an "evergreen" basis so that they automatically renew for a further year, unless Citibank give notice of non-renewal. Where practicable Citibank will give managing agents 60 days notice of non renewal to enable new arrangements to be put in place before the beneficiary receives its 30 days notice.

4.3.2 Each syndicate may request Citibank not to renew a LOC by giving Citibank at least 60 days notice prior to the end of the LOC term. The receipt of such notice by Citibank in respect of a multiple-syndicate LOC may result in the whole of that LOC being cancelled.

4.4 Collateral

4.4.1 Syndicates will be required to provide Citibank with collateral sufficient to cover such syndicate's share of the LOC to be issued.

4.4.2 Immediately prior to issuance of a LOC cash will move from the LDTF account of each participating syndicate (in an amount equal to such syndicate's share of that LOC) to a collateral account in the name of that syndicate secured in favour of Citibank.

4.4.3 Due to systems constraints the collateral must initially be in cash. Once in the collateral account a syndicate may invest it in accordance with criteria set by Citibank and agreed with Lloyd's. Such investments will be recorded in a Securities Collateral account which is charged in favour of Citibank.

4.4.4 Interest will accrue on cash collateral at a rate not less than the Citibank 3-month Eurodollar rate.

4.4.5 A price margin of 5% will apply to all collateral held in the form of securities and deposited in the Securities Collateral account. This margin will attempt to ensure that any adverse price movements do not reduce the value of the collateral below that of the LOC liability.

4.4.6 Citibank will have recourse to each syndicate in proportion to its participation in an issued LOC and therefore ultimately to the Names of the syndicate in proportion to their share of the syndicate stamp.

4.5 Electronic banking

Citibanking will enable syndicates to have full access to:

- (i) the status and outstanding balances and transactions at syndicate and LOC level;
- (ii) any separately established cash collateral (no physical access).

5.0 Cost of operating the facility

5.1 Set-up costs

The legal and administration costs of setting up this LOC facility will be recovered by charging an initial fee for drawing up the documentation for each syndicate. This fee will be dependant on time spent by Clifford Chance (the legal firm entrusted) to document and perform the required due diligence.

This fee will be debited using the same procedures as for other market charges. The fee becomes non-reversible once the legal documentation has been despatched.

5.2 Citibank charges

5.2.1 There is no commitment fee payable as this is an uncommitted facility. Other fees are payable if a syndicate uses the facility.

5.2.2 The facility will be charged to each syndicate at 0.30% per annum quarterly in advance based on a syndicate's total LOC outstanding liabilities.

5.2.3	Transaction charges:	Opening a LOC	-	\$25.00
		Increasing a LOC	-	\$12.50
		Reduction of a LOC	-	\$12.50
		Drawing on a LOC	-	\$12.50

5.2.4 Citibank's fees and commissions for the holding of investment instruments will equal those charged for standard custody services.

5.2.5 Movements between LDTF accounts and cash collateral accounts will cost \$1.50.

5.2.6 Fees and charges will be debited directly to LDTF account by Citibank upon the provision of 3 days notice to managing agents.

5.3 Mendes & Mount (M&M)

5.3.1 M&M currently provide a number of administrative functions in the U.S. in relation to the processing and monitoring of LOCs in the Lloyd's market. They attach a trust agreement to regulate drawings by the beneficiary and execute them on behalf of syndicates. Charges in respect of M&M are collected monthly based on the month end outstanding balance

6.0 Documentation

6.1 Managing agents wishing to take part in the Scheme will need to sign a Master Letter of Credit Agreement on behalf of the Names on each of their syndicates. Managing agents and the trustees of the relevant Names' LDTFs will also have to sign a Security Agreement providing Citibank with a first priority charge over the collateral held.

6.2 As the Master agreement and the Security agreement will create legally binding obligations on the parties thereto and whilst the documentation has had the benefit of legal input from Allen & Overy, any such legal advice has not been taken on behalf of managing agents and/or Names. You may therefore wish to take your own independent advice on the effect of these documents. The documents are however in a standard form and are not independently negotiable. Signed agreements are being required by Citibank as a condition for issuing LOCs on behalf of the syndicates. Managing agents who sign these documents must notify their supporting agents and advisors so that they can in turn advise the Names.

6.3 Further details are provided in the documentation summary below.

DOCUMENTATION SUMMARY

1. General

1.1 In order for a Managing Agent to utilise the facility on behalf of any of its syndicates the following documents will need to be signed:-

(a) Master LOC Facility Agreement - to be signed by a Managing Agent on behalf of **all** its syndicates notwithstanding the fact that such syndicate(s) may not write US business or wish to use the facility;

(b) Security Agreement - to be signed by a Managing Agent and the Managing Agent's Trustees;

(c) A letter appointing Mendes & Mount as the attorney of the Managing Agent to, amongst other things, execute certain Trust Agreements which regulate drawings on an LOC by the beneficiary; and

(d) A letter giving STFO the necessary authority to move cash from the relevant syndicate(s) LDTF account to the collateral account prior to LOC issuance.

1.2 The fees payable for providing LOCs under this facility will be set out in a letter from Citibank to each Managing Agent.

1.3 Once a Managing Agent has notified Lloyd's of its wish to utilise the facility, Citibank's lawyers, Clifford Chance, will customise documentation for each Managing Agent. Before signature the identity of the Managing Agent, Trustees and syndicates should be checked.

2. Master Agreement

2.1 A Managing Agent will sign this agreement on behalf of all of the members of Lloyd's participating on all of its syndicates with open years. Current syndicates will be specified in the agreement and the members of future syndicate years and new syndicates which require LOCs will become bound by the terms of the agreement upon an application for an LOC being made on their behalf by the Managing Agent. Therefore, this facility may be utilised by Managing Agents in respect of both future syndicate years and new syndicates without renewal or amendment of this agreement being required.

2.2 Unless provided otherwise, obligations under the agreement are ultimately the obligations of each Name who is a constituent of a syndicate for the year to which the LOC liability relates. The Managing Agent enters into such arrangements and makes certain representations and gives undertakings as agent for each Name. In particular, your attention is drawn to the following:-

(a) each Name represents that it has all necessary power to enter into the agreement, that the obligations are binding and that all necessary authorisations have been obtained; and

(b) each Name agrees to indemnify Citibank in respect of its share (in proportion to its share of the syndicate stamp) of any drawing (together with costs and expenses, again in proportion to its share of the syndicate stamp) under a LOC which was requested by a syndicate in which such Name is a participant for that year of account.

2.3 Each Managing Agent has certain obligations and makes representations and gives undertakings. In particular, your attention is drawn to the following:-

(a) each Managing Agent represents that it has and at all times will have all necessary power to enter into the agreement, that the obligations are binding and that all necessary authorisations have been obtained;

(b) the Managing Agent represents at the date of the agreement that it is not agent on behalf of any syndicate or Name which is a constituent (for any year) of such a syndicate not listed in the agreement; and

(c) each Managing Agent undertakes:-

- to notify Citibank if it ceases to be Managing Agent in respect of any relevant syndicate (for any year of account);

- to notify Citibank of any event of which it becomes aware which might materially prejudice the Managing Agent's or any Name's ability to perform its obligations;

- to request, where necessary, the members' agents to make funds available to satisfy a Name's obligations under the agreement and to procure appropriate cash calls are made;

- where a substitute Managing Agent is appointed, to use reasonable endeavours to procure that such a substitute signs a letter agreeing to assume all the Managing Agent's obligations and liabilities under the agreement.

- to deliver to Citibank information regarding the Names making up a syndicate for any year and the liability of each Name participating on a syndicate (for any year) upon whose application an LOC has been issued.

2.4 Each application shall specify the year of account and syndicate(s) in respect of which it is made. Where Citibank receives more than one application in respect of LOCs to be issued to the same beneficiary where such applications correspond, such applications may be dealt with as a multi-applicant LOC resulting in the issuance of a single LOC to the beneficiary. Each syndicate's obligations under that LOC will be in the same proportion as the amount set forth in the application bears to the total LOC amount.

Multi-syndicate LOCs will only be issued at the request of syndicates of the same year of account. Obviously, multi-syndicate LOCs can only be issued if all applicants have signed the necessary documentation.

2.5 Under the agreement Citibank has the right to combine applications for LOCs received from Lloyd's syndicates with LOC applications received from the Company market where such applications correspond. However, Citibank has given an undertaking to Lloyd's that it will not do this without the consent of Lloyd's.

2.6 Pursuant to the terms of the agreement Citibank may, in its discretion, establish or renew a LOC through a third party bank (e.g. if the beneficiary wishes to have a LOC issued or confirmed by a local state bank). Where such a third party bank is used the costs will be for the account of the syndicate applicants and ultimately the Names. Again, Citibank has given Lloyd's an undertaking that it will not do this without the consent of Lloyd's although Lloyd's will have no liability to Managing Agents/Names in respect of the giving of the consent.

2.7 LOCs will normally only be issued for a 12 month period. However, if requested by Managing Agents, Citibank will issue LOCs on an "evergreen" basis so that they automatically renew for a further year, unless Citibank gives Managing Agents notice of non-renewal. In such circumstances Citibank will give the beneficiary 30 days notice. Where practicable Citibank will give Managing Agents 60 days notice of non-renewal to enable new arrangements to be put in place before the beneficiary receives notice.

2.8 Each syndicate may request STFO not to renew a LOC by giving Citibank at least 60 days notice prior to the end of the LOC term. STFO should be advised as soon as possible, but no later than 65 days prior to the end of the LOC term. This time period allows Citibank to give the beneficiary the required 30 days notice of non-renewal. The receipt of such notice from one syndicate in respect of a multiple-syndicate LOC may result in the whole of that LOC being cancelled.

3. Security Agreement

- 3.1 This agreement is entered into by each Managing Agent and his relevant Trustees of the LDTFs. There will be a security agreement for each syndicate. Its purpose is to secure the obligations (if any) of each Name making up that syndicate for any year in relation to any LOCs issued under the Master Agreement. Such obligations include the amount of any LOC drawing together with that Name's proportion (if any) of any costs and expenses incurred by Citibank. If any amendment to the Lloyd's American Instruments impacts on this facility the collateral arrangements will need to be reviewed.
- 3.2 Managing Agents enter into the agreement and provide the security to Citibank pursuant to the authority vested in them by Clause 28(a) of the Lloyd's American Instrument.
- 3.3 In respect of a Name who is not a member of the syndicate at the date of the agreement but joins it at a future date, the submission by the Managing Agent of an application for an LOC in a year of account when that Name is a member of the syndicate constitutes acceptance by the Managing Agent of the giving of security on behalf of that Name's LDTF on the terms of the Security Agreement.
- 3.4 Syndicates will be required to provide Citibank with collateral prior to LOC issuance. This collateral must be sufficient to cover such syndicate's share of the LOC where issued on a multi-syndicate basis. In order to overcome potential problems with inter name lending across the years of account of a syndicate, collateral will be recorded and segregated on a syndicate year basis.
- 3.5 Due to systems constraints the collateral must initially be provided as cash which will be maintained by Citibank in an account in the name of the relevant trustees secured in favour of Citibank. Interest will accrue on this cash collateral at a rate determined at Citibank's discretion but which should not be less than Citibank's 3 month eurodollar rate which will be credited to that syndicate's LDTF account.
- 3.6 Once in the cash collateral account a syndicate may instruct Citibank to invest this cash in accordance with criteria set by Citibank and agreed with Lloyd's ("Investments"). Such Investments will be recorded in a securities collateral account charged in favour of Citibank and will bear a price margin of 5%. Where any collateral differs in currency to the currency of the LOC this will also bear a margin of 5%. This over-collateralisation will attempt to ensure that any adverse price movements in the Investments or currency (as the case may be) will not reduce the value of the collateral below the LOC liability. If the level of collateral does so fall in value the Managing Agents/Trustees are required to increase the level of collateral. Citibank shall, upon the request of the Managing Agent, release any collateral if such release will not result in the portfolio requirements being breached (i.e. release of return on Investments).

- 3.7 In order to avoid possible future problems of Citibank having effective security over cash held with it, Citibank have the right at any time to convert cash collateral into Investments at the risk of the Trustees. Citibank undertake to do this on a best execution basis and accept liability for negligence or wilful default.
- 3.8 If a drawing is made on a LOC Citibank will draw on the cash collateral account (designated by year of account) of each syndicate providing collateral for that LOC in proportion to each syndicate's participation. If this cash does not extinguish a syndicate's liabilities completely and/or that syndicate has collateral in the form of Investments, Citibank will open a drawings account where it will record the liability of that syndicate year. The debit balance on that account will constitute a loan from Citibank to the Managing Agent/Trustee of that syndicate and such a loan will be charged interest at a rate determined by Citibank until such time as the Investments are realised and/or any shortfall satisfied.
- 3.9 To the extent that any LOC obligation is not met and a drawings account records a liability on behalf of a syndicate, Citibank will have the right to sell or otherwise dispose of the whole or any part of the Investments and make any necessary currency conversions. The Managing Agents/Trustees appoint Citibank as their attorney to effect such a sale.

4. Mendes & Mount Appointment Letter

- 4.1 Each LOC beneficiary will be required to execute a Trust Agreement by which the beneficiary agrees only to draw on the LOC in connection with claims on the policy. By signing the appointment letter each Managing Agent appoints Mendes & Mount in New York to act as their attorney to execute the Trust Agreement on their behalf and to attach it to the LOC and forward it to the beneficiary for execution. It should be noted that whilst this may give Managing Agents a claim against the beneficiary for an incorrect drawing it does not prevent the drawing being made.

5. Delegation of Authority to Lloyd's

Each Managing Agent will be required to sign a letter which specifically gives STFO authority to transfer cash from the LDTF account of the syndicate to a collateral account prior to issuance of a LOC at the request of that syndicate.

THIS SUMMARY OF THE DOCUMENTS DOES NOT DESCRIBE ALL OF THEIR PROVISIONS. IT DOES NOT CONTAIN ANY DEFINITIVE ADVICE. READERS ARE URGED TO REVIEW THE DOCUMENTATION CAREFULLY AND IF IN ANY DOUBT TO CONSULT THEIR OWN ADVISORS. ANY REFERENCE TO A NAME INCLUDES A CORPORATE MEMBER. TRUSTEES AND MANAGING AGENTS MUST REMEMBER THEIR FIDUCIARY DUTIES AND THE INDIVIDUAL CIRCUMSTANCES OF THEIR SYNDICATES.

If you have any questions regarding the content of this bulletin please contact Donna Caddy (01634 392693), on Susan Mackenzie on the legal structure (0207 327 6361).

This bulletin has been sent to all active underwriters and managing agents' compliance officers.

Ian Wootten
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Settlement & Trust Fund Operations