Market Bulletin

LLOYD'S

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FROM:	Sarah Wilton, Project Director Open Years and Run-Off Management
LOCATION:	86/G4/Room 441
EXTENSION:	5712
DATE:	18 August 2003
REFERENCE:	Y3120
SUBJECT:	AMENDED RUN-OFF GUIDELINES
SUBJECT AREA(S):	
ATTACHMENTS:	Amended Run-Off Guidelines
ACTION POINTS:	**Underwriting agents and approved run-off companies to replace previous version of the Run-Off Guidelines issued with market Bulletin Y3085 on 30 June 2003 and to note contents of amended version**
DEADLINE:	**With immediate effect**

The Run-Off Guidelines issued under Market Bulletin Y3085 of 30 June 2003 have been updated and replaced by the amended Run-Off Guidelines attached to this bulletin. The purpose of this amendment is to make the Run-Off Guidelines easier to use, by the introduction of cross-references to the Underwriting Bye-Law (No. 2 of 2003) set out in Market Bulletin Y3085 issued on 30 June 2003.

Any queries relating to this bulletin should be referred to Eric Allman (020 7327 6772) eric.allman@lloyds.com or Peter Spencer (020 7327 6099) peter.spencer@lloyds.com.

This bulletin has been sent to all underwriting agents, approved run-off companies, Lloyd's market associations and recognised accountants.

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RUN-OFF GUIDELINES

1. Explanatory Note

1.1 These run-off guidelines are intended to assist managing agents who manage syndicates in run-off to plan and conduct run-offs efficiently and cost-effectively. They are also intended to ensure that Lloyd's is able to obtain the information needed to manage the franchise properly and enable it to take appropriate action to protect the franchise, should that be necessary.

1.2 Lloyd's seeks to achieve these objectives by assisting managing agents to adopt best practice in the conduct of their run-offs. The Franchise Performance Directorate ("FPD") will always seek to agree the best approach first. This usually requires professional advice to develop appropriate plans and high quality reporting to ensure the delivery of such plans.

1.3 These run-off guidelines are intended to set out the steps that a managing agent will ordinarily be expected to follow when –

a. the managing agent considers that there is a reasonable prospect that a syndicate under its management will, within the foreseeable future, permanently cease to underwrite new contracts of insurance and be placed into run-off;

b. the managing agent has taken the decision to permanently cease underwriting new contracts of insurance on behalf of a syndicate, other than by reason of a Lloyd's approved merger, and place it into run-off either immediately or at some point in the future. In these guidelines, such a syndicate is referred to as a "run-off syndicate";

c. managing a run-off syndicate; and

d. managing one or more syndicate years of account which have not been reinsured to close after 36 months but where the syndicate continues to underwrite for the current year of account. In these guidelines, such a syndicate is referred to as a "run-off account".

1.4 These run-off guidelines are intended to assist managing agents properly to protect the interests of the members of the syndicate in question, policyholders and Lloyd's, including the New Central Fund.

2. Obligation to keep the viability of syndicates under review

2.1 The decision to place a syndicate into run-off can have very serious consequences for the members of the syndicate, the managing agent and Lloyd's. Accordingly, the board of directors of a managing agent must keep the viability of each syndicate under its management under continuous review.

2.2 In order to encourage the best business practice in this regard, the board of directors should consider regularly whether there is a reasonable prospect that a syndicate under its management will, within the foreseeable future and for a period not less than 12 months, permanently cease to underwrite new contracts of insurance and reinsurance, and so be placed into run-off. The board's considerations should be fully minuted.

2.3 In the event that the board of directors has any concern about the future viability of any syndicate under its management, the compliance officer must immediately inform the FPD and provide such additional information as will be necessary for the FPD to assess the position. These requirements will be prescribed under paragraph 75 of the Underwriting Byelaw.

2.4 The FPD will ordinarily seek to meet with representatives of the managing agent as soon as possible to discuss the position in an open and constructive manner.

2.5 As soon as a managing agent decides that a syndicate under its management is to cease underwriting, the managing agent will have 60 days to prepare a detailed run-off closure plan, in accordance with Regulatory Bulletin 28/2000 and Lloyd's letter to all agents of 18 December 2002. The FPD will normally require the managing agent to prepare an interim plan, both before and after entering run-off, and also to discuss the contents of the run-off closure plan before it is finalised. This is laid out more fully in Sections 3 and 4 below.

3. Steps to be taken prior to run-off - preparation of a run-off contingency plan

3.1 If, following the meeting between the FPD and the managing agent, it is concluded that there is a reasonable prospect that a syndicate will be placed into run-off at some point in the foreseeable future, the managing agent will ordinarily be required to prepare a run-off contingency plan. The managing agent will also usually be expected to –

a. obtain professional run-off advice to assist it in the preparation of the run-off contingency plan;
b. appoint a director to have the day to day responsibility for the preparation and review of the run-off contingency plan.

3.2 The information in the run-off contingency plan is set out in two parts. Part A includes information relating to the management of the syndicate whilst it continues to underwrite. Part B includes information relating to the management of the syndicate following a decision to place the syndicate into run-off.

Lloyd's will issue separate guidance on the detailed contents of the run-off contingency plan, which will be available from the FPD in due course. These will be prescribed under paragraph 78 of the Underwriting Byelaw.

3.3 Once the run-off contingency plan has been prepared and agreed with the FPD, the managing agent will be expected to manage the operation of the syndicate in accordance with the plan.

4. Where a Syndicate is placed into Run-Off

4.1 This can happen in a number of situations –

a. where a managing agent has decided to place a syndicate into run-off with immediate effect where this had not been foreseen by the managing agent and no run-off contingency plan has been prepared (an "Unplanned Run-Off");
b. where a syndicate has been placed into run-off with immediate effect where a run-off contingency plan has been prepared (a "Planned Immediate Run-Off");
c. where a managing agent has taken the decision to place a syndicate into run-off at some determined date in the future (a "Planned Delayed Run-Off").

An Unplanned Run-Off

4.2 It is expected that an unplanned run-off will be highly unusual if managing agents comply with their obligations under section 2 above. In the event that a managing agent convenes a board meeting for the purposes of deciding whether to place a syndicate into run-off with immediate effect and where the FPD is not already on notice of this, the compliance officer must immediately notify the FPD and provide such additional information as will be necessary for the FPD to assess the position.

An urgent meeting between the managing agent and the FPD will usually be convened prior to the board meeting, in order to discuss the position in a constructive manner.

4.3 It is recommended that the managing agent receive, prior to or at the board meeting, legal advice relating to all its obligations, including its obligations under the relevant managing agent's agreements with the members of the syndicate and under Lloyd's rules generally.

4.4 There are actions required in the early stages of a run-off in order to ensure that the run-off is conducted in an efficient manner. These actions will be discussed with the FPD at an early stage, and the managing agent will ordinarily be required to prepare and implement a plan in the form of Part B of the run-off contingency plan (see Paragraph 3.2) and a run-off closure plan. The managing agent will also ordinarily be required to obtain professional run-off advice to assist in the preparation of those plans and to appoint a director to have day to day responsibility for the preparation, review and implementation of the run-off closure plan.

4.5 The managing agent will ordinarily have 60 days in which to finalise the run-off closure plan. However, during that period, the managing agent will ordinarily be required to report to the FPD regularly on the implementation of Part B of the run-off contingency plan and on the progress towards completion of the run-off closure plan.

A Planned Immediate Run-Off

4.6 A managing agent will normally have developed its run-off contingency plan as the prospect of run-off increases so that it includes greater detail in respect of Part B (information relating to the management of the syndicate following a decision to place the syndicate into immediate run-off).

4.7 The managing agent may have prepared a run-off closure plan. If not, the managing agent will be required to do so, in accordance with regulatory Bulletin 28/2000 and Lloyd's letter to all agents of 18 December 2002.

4.8 If it has not already done so, the managing agent will ordinarily be required to obtain professional run-off advice to assist it in the preparation of the run-off closure plan and to appoint a director to have the day to day responsibility for the preparation and review of the run-off closure plan.

4.9 The managing agent will ordinarily have 60 days in which to finalise the run-off closure plan. However, during that period, the managing agent will ordinarily be required to report to the FPD regularly on the implementation of Part B of the run-off contingency plan and on the progress towards completion of the run-off closure plan.

A Planned Delayed Run-Off

4.10 Where the managing agent decides following a meeting with the FPD that a syndicate will cease underwriting at some future date ("the effective date"), it will ordinarily be required to take the following actions –

a. prepare and submit to the FPD a short-term management plan. This will address the management of underwriting up to the effective date, so as to minimise the cost and duration of the run-off. The short-term management plan should include the information referred to in Part A of the run-off contingency plan. Managing agents will be expected to manage the syndicate and its underwriting in accordance with this plan;

b. prepare and submit to the FPD a short-term action plan, based on Part B of the run-off contingency plan (Information relating to the management of the syndicate following the decision to place the syndicate into immediate run-off);

c. prepare and submit to the FPD a run-off closure plan (see paragraph 2.5 above).

4.11 The timing of the preparation and submission of each of the plans will be discussed with the managing agent and monitored by the FPD.

5. General approach to run-off syndicates and Accounts

5.1 Every managing agent managing a run-off syndicate or a run-off account must seek to close the relevant years of account at the earliest possible time consistent with the proper performance of its duties as managing agent of the syndicate. The managing agent must adopt objectives, strategies and plans supporting and evidencing adherence to this requirement.

5.2 The FPD will therefore expect a managing agent to adopt a professional project management approach to the management of run-off. In particular, the managing agent will ordinarily have to –

a. consider who is best placed to manage the run-off and whether the appointment of a substitute agent or an approved run-off company would be appropriate;
b. keep the suitability of the run-off closure plan under continuous review, amend the plan as necessary and manage the run-off in accordance with the run-off closure plan.

6. Who should manage and conduct the Run-Off?

Substitute agents

6.1 Whenever a managing agent proposes to leave a year of account open as a run-off account or to place a syndicate into run-off, the FPD will undertake a review of the managing agent to determine whether the managing agent is the most appropriate person to manage the run-off having particular regard to the interests of –

a. policyholders;
b. any unaligned members of the syndicate (having consulted with them through their members' agents); and
c. the interests of any member of the syndicate supported by payments from the New Central Fund.

6.2 If the FPD considers that the managing agent may not be the most appropriate person to manage the run-off and that the appointment of a substitute agent may therefore be in the interests of the members and policyholders of the syndicate, it will seek to agree an appropriate course of action with the managing agent. In the absence of agreement, the FPD may make arrangements to appoint the most appropriate person to manage the run-off.

Run-off companies

6.3 The Underwriting Byelaw provides that a managing agent may, upon the approval of the Franchise Board, delegate any of its executive functions, insurance functions and administrative and processing functions to another managing agent or an approved run-off company.

6.4 In every case, a managing agent which is to manage a run-off syndicate or a run-off account, must consider whether to delegate some or all of the conduct of the run-off to another managing agent or an approved run-off company.

6.5 The board of directors of a managing agent must give careful consideration to the following factors when deciding whether to delegate any of its functions –

a. the interests of the members and policyholders of the syndicate;
b. the skills, experience and resources of the managing agent to manage and conduct the run-off efficiently;
c. how the managing agent will manage any conflicts of interest identified in the run-off closure plan.

6.6 The above factors should be set out in writing and must be discussed with the FPD in advance of the board meeting at which any delegation may finally be decided. The FPD will seek to work with the managing agent in its analysis of these factors.

6.7 The managing agent should identify suitable approved run-off companies or managing agents which would be prepared to conduct the run-off. The managing agent should discuss its choices with the FPD and consider whether a formal tendering process should be commenced. The FPD can assist managing agents and will be able to provide guidance on matters that must be included in all run-off agreements.

6.8 The managing agent will ordinarily be required to notify the FPD of its board's decision with regard to delegation and set out its reasons for the decision. The FPD will review the decision with the managing agent, and may require the managing agent to review its decision or, exceptionally, direct the managing agent to adopt a different run-off strategy with regard to delegation.

7. The Management and conduct of run-off syndicates and Accounts

Responsibility of the managing agent

7.1 In every case, the managing agent is responsible to the members of the syndicate for the management of the run-off notwithstanding that an approved run-off company has been appointed or functions have been delegated to another managing agent. Accordingly, the managing agent must adopt proper procedures and controls to monitor, control and actively manage any approved run-off companies appointed by it.

7.2 The managing agent and approved run-off companies must in all cases continue to have regard to the relevant Codes of Practice relating to Sound and Prudent Management, Compliance with Regulatory Requirements and Managing Underwriting Risk (in particular, the supervision of claims, administrative and accounting staff, managing the reinsurance programme, settling and paying claims and determining reserves and premiums for reinsurance to close).

7.3 In addition, managing agents and approved run-off companies must properly plan and manage –

a. the cost-effective mitigation of unexpired risk;
b. agreement and settlement of claims;
c. the resources required to conduct the run-off according to the run-off closure plan;
d. financial management;
e. reporting against the run-off closure plan to the board, members and the FPD.

Further detail of each of these is set out in Sections 8 to 12 below.

8. Exposure Management

Cessation of underwriting

8.1 This will usually include the following –

a. immediately terminating the existing authority of directors, officers and employees of the managing agent to –

   i. enter into new contracts of insurance;
   ii. amend, extend, endorse or renew existing contracts of insurance;
   iii. enter into new delegated underwriting arrangements;
   iv. amend, extend or renew existing delegated underwriting arrangements.

b. immediately taking custody of all underwriting stamps;
c. immediately terminating lineslips on which the relevant syndicate participates;
d. seeking to terminate other delegated underwriting arrangements as soon as possible;
e. delegating limited authorities to directors and senior employees in accordance with the run-off contingency plan or run-off closure plan.

8.2 The FPD will provide managing agents with guidance as to how they may achieve the matters set out above when they prepare either the run-off contingency plan or the run-off closure plan.

Identifying and recording contracts of insurance that have been underwritten

8.3 The FPD considers that it is essential for the professional project management of run-off that managing agents maintain full, accurate and complete records of all contracts of insurance underwritten by the syndicate. These records will include slips, contract wordings and records relating to contracts written under delegated underwriting arrangements.

8.4 The review, verification and where appropriate the completion of these records forms a key element of the run-off contingency plan and the run-off closure plan. However, if there remain any material errors or omissions in the managing agent's records at the commencement of a run-off the managing agent must complete and verify the records as a matter of the highest priority. The managing agent will be expected to be able to demonstrate the adequacy of the records to the FPD early in the run-off.

Cancelling, commuting and replacing contracts of insurance

8.5 Managing agents should carefully review all contracts of insurance underwritten by the syndicate to determine whether there is any scope for seeking to cancel, commute or replace those contracts, in accordance with the wording of the contracts. Considerable care must be taken at all times to ensure that any proposed step will not adversely affect the members of the syndicate or the reputation, ratings or licences of the Society. Where necessary, all proposed steps which may have that effect must first be discussed with and agreed by the FPD before any action is taken.

Effective use of reinsurance

8.6 This will usually include the following –

a. assessment of the likelihood of loss and probable quantum arising from the syndicate's underwriting;
b. identification of all existing contracts of reinsurance for the benefit of the syndicate in question and the assessment of all restrictions and limitations in respect of those reinsurances;
c. assessment of the adequacy of those reinsurances having regard to all of the contracts of insurance and reinsurance underwritten by the syndicate, remaining coverage, reinsurance security, and disputes; and
d. consideration of the prudence and cost effectiveness of purchasing additional reinsurance and the availability of such reinsurance.

8.7 Managing agents should consider in any proposed reinsurance purchase that the appetite for risk of the members of the syndicate may have changed, following the cessation of underwriting, and that as the syndicate is now in run-off, it should not normally be seeking to accept additional risk through amendments to its approach to reinsurance.

9. Claims Management

9.1 Management of claims will usually include the following:

a. immediately terminating the existing authority of directors, officers and employees of the managing agent to –

i. agree or decline in whole or part new claims;
ii. agree, decline or amend in whole or part existing notified claims;
iii. compromise claims;
iv. negotiate on behalf of the syndicate in respect of disputes or contentious claims.

b. immediately terminating delegated claims authorities, where possible, and where alternative procedures have been put in place.

c. delegating limited claims agreement authorities to directors and senior employees in accordance with Lloyd’s relevant Codes of Practice, but excluding any authority to make ex-gratia or other payments for which there is no legal liability unless the FPD has given its approval for such payments.

10. Resources

Human resources

10.1 Where a syndicate goes into run-off there is a risk that staff who are essential to the effective management of the run-off will leave. Accordingly, the managing agent must –

a. identify members of staff with skills, knowledge and experience that are essential to the effective management of the run-off;
b. take steps to secure the ongoing services of such staff;
c. identify any additional skills and experience required; and
d. take steps to secure access to such skills and experience.

10.2 The adequacy of human resources should be kept under continuous review by the managing agent during the course of the run-off.

IT systems

10.3 Managing agents should secure access to the necessary IT systems, including hardware, software and data at the earliest opportunity. The planning for this should be included in any plans required to be prepared under these guidelines.

10.4 Managing agents should give careful consideration to whether their systems are suitable for the purposes of run-off, and should normally take professional run-off advice on this matter. Nevertheless, before any material change is made, the board should approve it, after considering a detailed justification on cost and other grounds. Where a run-off agent is employed, the board should make the same consideration before permitting the run-off agent to transfer to another system.

11. Financial Management

11.1 Managing agents remain responsible for the efficient management and safeguarding of the syndicate's assets. Sound and prudent financial controls must be in place over the following –

a. non-insurance assets, liabilities and solvency;
b. cashflow;
c. premium and reinsurance credit control;
d. investment management;
e. expenses.

11.2 As soon as possible, after the syndicate has entered run-off, managing agents should make a detailed assessment of the total cost of the run-off, identifying extra costs arising from the decision to cease underwriting. The assessment should be kept under continuous review and updated as appropriate. Matters to be considered include –

a. claims reserves and the potential for deterioration;
b. bad debt provisions and the potential for deterioration;
c. future reinsurance costs;
d. the costs of the run-off;
e. any risk premium payable on reinsurance to close, or any other costs relating to closure of the run-off.

12. Planning & Reporting

Reporting to Lloyd's

12.1 Lloyd's has issued extensive guidance requirements to managing agents concerning run-off planning and reporting to Lloyd's, which managing agents are urged to consult.

12.2 Managing agents will also be subject to a monitoring regime appropriate to the size and risk inherent to the syndicates in run-off under their management. This regime may involve regular meetings with FPD and additional reporting. FPD makes a regular assessment of such risks based upon the planning and reporting prepared by the managing agent reporting to members.

12.3 Managing agents must continue to report as usual to members. They should also consider whether additional reporting would be of value to members and, where they consider that it would, they should provide it.

13. Contacts

13.1 In the event of any queries concerning this guideline, please contact Eric Allman (tel. 020 7327 6772) or Peter Spencer (tel. 020 7327 6099) in FPD.

13.2 If you need to contact FPD in connection with a possible or impending run-off, please contact Sarah Wilton (tel. 020 7327 5400) or Lorraine Adlam (tel. 020 7327 5552) in FPD.