LLOYD'S

MARKET BULLETIN

REF: Y4030

Title	Payment of managing agent's profit commission in line with interim profits released to members.
Purpose	To advise managing agents how profit commission may be paid on account on an open year.
Type	Event
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Date	27 June 2007
Deadline	
Related links	

Summary

The managing agent's agreement has been amended to enable managing agents to receive payment on account of anticipated profit commission in line with interim profits released to members.

Amendment to managing agent's agreement

Under the previous managing agent's agreement, profit commission was only payable to the managing agent on the closure of the relevant year of account and despatch to the member of the underwriting year accounts showing the audited closed year result in respect of the relevant year of account.

The amendment to the managing agent's agreement permits managing agents to make payments on account of their anticipated profit commission from the syndicate premiums trust funds prior to the closure of a year of account where they have transferred open year surpluses (interim profits) from the syndicate level premiums trust funds to the members' personal reserve fund. Any payments on account of such commission will be restricted to the profit commission expensed in the profit and loss account in striking the level of interim profits declared and subsequently released. (See worked example A in Appendix 1). The profit commission calculation should use the same rates of exchange as used in calculating the interim profit release to members.

Managing agent capital and solvency

This change aligns agents' remuneration with that of the members. It mitigates a potential cash flow problem that managing agents may experience as profit commission is normally recognised in the agent's accounts as it is earned and the associated issue for managing agents in meeting the Lloyd's capital and solvency requirements.

In developing this proposal a concern was raised that the interim profits declared may be eroded by subsequent losses and there should be a mechanism to ensure that, in such circumstances, the surplus early release of PC can be repaid. The Lloyd's capital and solvency requirements for agents have been revised to disallow the payment on account of profit commission, net of tax, as an asset in the minimum net assets requirement, which is a comparison of the net assets of the agent with a percentage of capacity under its management. Note that this does only apply to the calculation of the minimum net assets requirement and not the net current assets margin.

Managing agents do not need to advise Lloyd's of any releases but should include the relevant amounts on subsequent quarterly/annual financial returns. Profit commission received on account should be reported through line (vii)(d) of the AF1 or QF1. This line is normally used for deduction of 100% of any debt that is due from an entity in the same group and where the Franchise Board considers such a deduction appropriate. While the accelerated profit commission does not represent a debt from another entity in the group this line is considered the most appropriate until such time as the software can be amended (see worked example B in Appendix 1).

Immediate effect

The change to the agency agreements is effective immediately and managing agents will now be able to receive payment on account of anticipated profit commission at the same time that the related interim profits are released to members' personal reserve funds. Furthermore, where interim profits on run-off years and the 2005 and 2006 years of account were released to members as at 31 December 2006 (or earlier), managing agents may now take payment on account for the related anticipated profit commission.

Queries

Any queries or comments on the return should be submitted via e-mail to Market Reporting (lloyds-MRD-ReturnQueries@lloyds.com).

John Parry

Appendix 1

Worked examples

A: Profit commission calculation

Rate of profit commission: 15%
Deficit clause: loss of £20m carried forward – all taken against initial profit transfer
£65m of profits retained within syndicate to cover cashflow requirements.

	Profit commission calculation	Profit released to members	Total
	£	£	£
Profit declared prior to managing agent's PC			120,000,000
PC charged ((120 – 20)*15%)			(15,000,000)
Net recognised gains and losses per AR100 line 54			105,000,000
Gross profit for release to members	43,000,000	43,000,000	
Deficit clause	(20,000,000)		
Profit for managing agent PC calculation	23,000,000		
Profit commission payable (23 * 15%)		(3,000,000)	
Net profit released to members			(40,000,000)
Retained profit			65,000,000

Amount of advance profit commission payable is £3,000,000

B: Extract from A/QF1 – Part III Minimum net assets requirement

	£	£
Net assets / (liabilities)		4,000,000
Less		
(vii) One hundred percent of a debt due from an entity in the same group		
(d) the Franchise Board considers such a deduction to be appropriate (3,000,000 less tax at 28%)	2,160,000	
		2,160,000
Net assets, as adjusted		1,840,000
Less the higher of:		
(a) minimum qualifying capital: and	400,000	
(b) derived net assets	750,000	
Surplus / (shortfall)		1,090,000