

MARKET BULLETIN

REF: Y4456

Title	Update regarding the clarification of Part XIII of the Canadian Insurance Companies Act – Attorney in Fact Signing Process
Purpose	To highlight recent discussions with OSFI regarding Lloyd's business models in Canada, and the implications that the clarification of "insure in Canada a risk" in Part XIII of the Insurance Companies Act has for Lloyd's business models and processes
Type	Event
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Date	21 December 2010
Deadline	
Related links	

1 Purpose

- 1.1 To highlight the discussions that have been ongoing with the Canadian regulator, the Office of the Superintendent of Financial Institutions (OSFI) regarding the status of open market and reinsurance business following the implementation of the clarification of Part XIII of the Canadian Insurance Companies Act (Part XIII), and the practical implications for Lloyd's business processes.
- 1.2 To set out:
- a) the need to introduce an Attorney in Fact (AIF) signing process for Canadian open market and reinsurance business (section 3);
 - b) the status of business written before the AIF process is introduced (section 4); and
 - c) the implications for business written via underwriting authority delegated to coverholders or service companies (section 5).
- 1.3 To emphasise that Managing Agents and Brokers should not amend their existing practices in respect of Canadian open market and reinsurance contracts until such time as the AIF signing process is operational.

2 Executive Summary

- 2.1 A clarified interpretation of “insure in Canada a risk” was issued by OSFI with effect from 1/1/2010 (the effective date).
- 2.2 This applies the Canadian federal regulatory framework to all risks *insured* in Canada, as defined in OSFI Advisory 2007-01-R1, rather than to all risks *located* in Canada. All business insured in Canada from the effective date, and any such business already on a company’s books at that date, is subject to the clarified definition and to federal reporting and funding requirements – regardless of the location of the policyholder or risk, or of the class of business.
- 2.3 Throughout 2009, Lloyd’s had a dialogue with OSFI regarding the existing business models for open market and reinsurance business, gaining in principle agreement that these models were such that business written using them could possibly be “insure in Canada a risk”, and prompting market bulletins Y4283 and Y4329. However, further dialogue with OSFI has made clear that going forward amendments needed to be made to our business models to ensure that open market and reinsurance business will be considered “insure in Canada a risk”.
- 2.4 Following a review of options, and following consultation with the Canadian Legislation Market Working Group, it has been determined that a process whereby the AIF for Lloyd’s Underwriters in Canada will sign each Canadian open market and reinsurance contract is appropriate.
- 2.5 Lloyd’s has discussed its proposals with OSFI, and OSFI has agreed that business written using the proposed AIF signing process would be considered “insure in Canada a risk”. Lloyd’s will now work with the market and other key stakeholders to design, build and implement an appropriate AIF signing process in 2011. Once the AIF signing process is established, Lloyd’s underwriters (in accordance with the procedures to be adopted) will need to direct all relevant new and renewal Open Market and reinsurance contracts through the new process.
- 2.6 OSFI has agreed that Lloyd’s may continue to reflect all Lloyd’s Canadian business written prior to the introduction of the AIF signing process and the associated liabilities in the Lloyd’s Underwriters P&C2 return and vest assets in the Lloyd’s Canadian Trust Funds in order to meet any associated liabilities.
- 2.7 OSFI has agreed that Lloyd’s Canadian cedants whose risks were reinsured prior to the introduction of the new AIF Signing Process may continue to take capital/asset credit for reinsurance purchased from Lloyd’s Underwriters given Lloyd’s commitment to OSFI to both reflect these risks and their associated liabilities in the Lloyd’s Underwriters P&C2 return and vest assets in the Lloyd’s Canadian Trust Funds in order to meet any associated liabilities.

3 AIF signing process

- 3.1 Lloyd's proposes to establish a business process by which an insurance contract written in London in respect of risks located in Canada or a reinsurance contract in respect of a Canadian cedant will be replaced by a contract made in Canada.
- 3.2 This will entail Lloyd's underwriters' attorney and chief agent in Canada (the "AIF") on behalf of the members of the syndicates writing such risks endorsing the contract made in London with a statement complying with section 578(5) of the ICA and to sign that contract in Canada on behalf of the syndicate members. The AIF shall then send the new contract, so endorsed and signed, to the policyholder or his broker.
- 3.3 The intention is that the contract signed by the AIF in Canada will, once communicated by the AIF from Canada to the policyholder or his broker, replace the original contract made in London in accordance with the typical Lloyd's market placement procedures outlined below (and as described in Lloyd's note to OSFI in March). The AIF signed contract will thus be a contract bound on behalf of underwriters in Canada (OSFI Advisory, indicia 2(e)) and will be the governing document. The terms of the new contract as signed by the AIF shall be, apart from the addition of the section 578(5) statement, in exactly the same terms as the prior contract concluded in London.
- 3.4 It is intended that those acting on behalf of the relevant parties in the placement of the risk (the brokers acting for the policyholder/cedant and the managing agent acting for the underwriters) will agree with the process, and in particular, agree that the contract signed in Canada by the AIF will replace the original London made contract.
- 3.5 There will be no gap in coverage arising on the replacement of the original contract made in London with that signed by the AIF in Canada as the terms of the two contracts will be identical. In the event of a claim, this will be dealt with under whichever is for the time being the governing document. Initially this will be the slip scratched in London but once this is followed by the AIF signed slip, the contract will be contained exclusively in this later contract which the parties have agreed, or intended, should replace the earlier contract. Thus, once the subsequent contract is made, it will prevail and any claim will be made under the contract made in Canada and this will be the case regardless of whether the loss occurs, or a claim is notified, prior to the making of this subsequent contract.
- 3.6 The effect of this subsequent contract signed by the AIF will be to ensure that the business in question is Canadian regulated business and the Canadian policyholder will be a beneficiary of the Lloyd's trust funds in Canada. Accordingly, liabilities under this subsequent contract will be Permitted Canadian Trust Outgoings as defined in the LCTD.
- 3.7 Lloyd's is in the process of establishing project governance to undertake the design, build and implementation of an appropriate AIF signing process. However, it is envisaged that the basic steps in the AIF signing process will typically be as follows:

Stage 1 – each Lloyd’s managing agent writing Canadian open market and reinsurance business required to enter into mandate letter/indemnity for benefit of the AIF.

1. Each Lloyd’s managing agent writing Canadian open market business and reinsurance business on behalf of syndicates under its management will be required by Lloyd’s to enter into a mandate letter and indemnity for the benefit of the AIF, authorising the AIF to confirm Lloyd’s underwriters’ coverage by signing in Canada insurance contracts in respect of such business on behalf of the syndicate members and to include in the insurance contract wording which complies with Appendix A of OSFI’s instructions dated December 2008. This wording is the “made in Canada” wording, as required by sub-section 578(5) of the ICA, referred to in Appendix 3 of market bulletin Y4329 and currently encapsulated in LSW 1669, 1670, and 1671. Under the AIF signing process, this wording will no longer need to be added to the contract formed in London, as it will accompany the AIF signature. The basic wording will be as follows –

Wording for Statement - Subsection 578(5) of the ICA

For purposes of the Insurance Companies Act (Canada), this document was issued in the course of Lloyd’s Underwriters’ insurance business in Canada.

The business insured/reinsured hereunder meets the necessary conditions to qualify as, and is being transacted as, “insuring in Canada a risk” in accordance with Part XIII of the Insurance Companies Act (Canada).

Alternative versions or arrangements may be needed to reflect global contracts, and mixed market risks.

The mandate letter will also authorise the AIF to send, from Canada, the insurance contract to the policyholder or his broker.

Lloyd’s will send a mandate letter to each Managing Agent for signing under separate cover. The signed mandate letters will be collated by Lloyd’s and sent to the AIF in Canada for his records so that he can check to make sure that he can sign any particular contract.

Stage 2 – Request for insurance from policyholder

2. The Canadian broker, as agent of the proposed policyholder, will receive a request from its client, the proposed policyholder, for it to seek terms regarding a proposed contract of insurance. The client will (normally in conjunction with the broker) specify the risks that are to be insured, the period of cover, proposed premium and other key requirements of the contract.

Stage 3 – slip prepared by Canadian broker and/or Lloyd’s broker on behalf of the Canadian policyholder

3. The Canadian broker (and/or the Lloyd’s broker) will prepare a slip setting out the key terms of the proposed contract.
4. The “slip” is the term given to the document which records the essential details of the proposed contract of insurance and is an expression of willingness to contract on specified terms.
5. The presentation of the slip by the broker to underwriters constitutes an offer on behalf of the policyholder, and the scratching of the slip on behalf of the underwriters constitutes an acceptance of this offer by them to the extent of their subscribed line. The slip is presented with the intention that it is to become a binding contract as soon as it is accepted by the person to whom it is addressed although the test of whether the presentation of a slip by the broker constitutes an offer (as opposed to, for example, a mere request for a quote) is objective.
6. The broker will ensure that the slip includes a form of wording to record the parties’ intention to replace the contract concluded in London with a second contract made in Canada through the AIF signing process in order for the insurance to be “insuring in Canada a risk” within the scope of the Insurance Companies Act (Canada).
7. The template form of slip used in the London Market (known as the Market Reform Contract) already includes within it a designated place for inclusion of wording where further insurance contract documentation is to be prepared after the slip is scratched (for example, where the broker wishes to prepare a full policy wording document for his client). The relevant form of wording which managing agents and brokers should use in the slip is –

Clause wording

“Whereas Lloyd's underwriters have been granted an order to insure in Canada risks under the *Insurance Companies Act* (Canada) and are registered in all provinces and territories in Canada to carry on insurance business under the laws of these jurisdictions or to transact insurance in these jurisdictions.

And whereas applicants for insurance coverage in respect of risks located in Canada and Canadian cedants wish that Lloyd's insurance or reinsurance coverage be provided in a manner that requires Lloyd's underwriters to vest assets in trust in respect of their risks pursuant to the *Insurance Companies Act* (Canada).

(a) this contract shall be in force and shall be the governing contract pending the decision by Lloyd’s underwriters’ attorney and chief agent in Canada (the “AIF”) to confirm coverage in accordance with both the terms and conditions set out in this contract and applicable Canadian law;

(b) the AIF shall confirm Lloyd’s underwriters’ coverage by signing in Canada a policy that will contain the terms and conditions set out in this contract (the “Canadian Policy”), and by communicating from Canada the issuance of that policy to the policyholder or his broker;

(c) this contract shall cease to have effect upon the communication by the AIF from Canada of the Canadian Policy to the policyholder or his broker, and the Canadian Policy will replace and supersede this contract.”

Note – this clause will in due course be mandated and will be assigned an LSW reference.

Stage 4 – slip presented by Lloyd’s broker to managing agent of lead syndicate. Lead syndicate signifies its agreement by scratching the slip

8. The broker presents the slip to the managing agent of the proposed lead Lloyd’s syndicate, inviting subscriptions and negotiating terms, including the premium, and the proportions of the cover to be underwritten.
9. If the underwriter is prepared to enter into the contract of insurance on behalf of the syndicate he will initial (scratch) the slip and stamp it with the syndicate stamp. At that moment, a series of binding contracts are formed between the insured and each member of the syndicate. The lead underwriter will specify what proportion of the risk the syndicate has underwritten.

Stage 5 – slip presented by Lloyd’s broker to managing agent(s) of following syndicate(s)

10. If the lead syndicate has not underwritten 100% of the risk the broker will present the slip to other underwriters (“following underwriters”). Again, presentation of the slip by the broker to the underwriter constitutes an offer by the broker made on behalf of the policyholder. If a following underwriter is prepared to enter into the contract of insurance on behalf of the syndicate he will initial (scratch) the slip and stamp it with the syndicate stamp. At that moment, a second series of binding contracts are formed between the policyholder and each member of the following syndicate.

Stage 6 – [where relevant] Lloyd’s broker signs down lines

11. In the event that more than 100% of the risk has been underwritten, the broker may reduce the proportion of the risk that each syndicate has underwritten so that 100% of the risk is underwritten. This practice, known as signing down, is recognised by the English courts.

12. Until a further document is produced the scratched slip evidences all of the contracts of insurance between the policyholder and the members of each syndicate, with each member being severally liable for their contracts with the policyholder.

Stage 7 – final signed slip (including signed down lines) emailed to Lloyd’s Canada (for the AIF)

13. The final scratched slip (including signed down lines) will then be sent electronically by the Lloyd’s broker (acting for the policyholder) to the AIF in Canada.
14. Pending the decision of the AIF to confirm coverage, the contract bound in London shall be in force and shall be the governing contract.

Provided he has authority from the relevant managing agent(s) and is satisfied that coverage should be confirmed the AIF will (consistent with the terms agreed by the parties by use of the clause referred to at paragraph 7 above) -

- a. insert the section 578(5) “made in Canada” wording;
- b. sign (using an appropriate electronic system) in Canada the contract on behalf of Lloyd’s underwriters which contains the terms and conditions as set out in the contract (hereinafter the “Canadian Policy”); and
- c. send the Canadian Policy to the policyholder or his broker.

The AIF will endeavour to take the necessary steps to sign the contract within two working days of receipt of the final slip from the Lloyd’s broker.

15. The contract bound in London shall cease to have effect upon the communication by the AIF in Canada of the Canadian Policy to the policyholder or his broker. At this point, the new contract, “bound” in Canada, made between the members of the syndicate subscribing to the risk and the Canadian policyholder will have effect.
16. This Canadian Policy will replace and supersede the contract bound in London and by virtue of being bound in Canada, will ensure that the Canadian policyholder is a primary beneficiary under the LCTD and that all premiums and other underwriting receipts in connection with that policyholder’s contract must be paid into the LCTF. Equally, payment of a valid claim under the new contract as signed by the AIF will be a Permitted Canadian Trust Outgoing for the purpose of the Lloyd’s Canadian Trust Deed.

4 Business written prior to the introduction of the AIF signing process

- 4.1 All Lloyd's Canadian business written and presented as such has been regarded and treated by Lloyd's as 'insuring in Canada a risk'. Lloyd's has reported this business as such in its P&C-2 returns during 2010, and the LCTF has been funded accordingly.
- 4.2 OSFI has agreed that Lloyd's may continue to reflect these risks and their associated liabilities in the Lloyd's Underwriters P&C2 return and vest assets in the Lloyd's Canadian Trust Funds in order to meet any associated liabilities.
- 4.3 The Part XIII status of reinsurance business is of particular import. We expect that some of our cedants will request confirmation that they can continue to take capital/asset credit for reinsurance purchased from Lloyd's Underwriters prior to the introduction of the AIF signing process.
- 4.4 OSFI has agreed that Lloyd's Canadian cedants whose risks were reinsured prior to the introduction of the new AIF signing process may continue to take capital/asset credit for reinsurance purchased from Lloyd's Underwriters given Lloyd's commitment to OSFI to both reflect these risks and their associated liabilities in the Lloyd's Underwriters P&C2 return and vest assets in the Lloyd's Canadian Trust Funds in order to meet any associated liabilities. Brokers and Underwriters should undertake reasonable due diligence to ensure the appropriate treatment of risks and liabilities when providing such confirmation to cedants.
- 4.5 Once the AIF signing process is established, Lloyd's underwriters (in accordance with the procedures to be adopted) will need to direct all relevant new and renewal reinsurance contracts and Open Market policies through the new process.

5 Implications for business written via Canadian domiciled coverholders or service companies

- 5.1 The nature of the activity undertaken in Canada for and on behalf of Lloyd's by Canadian domiciled coverholders or service companies is such that business written via underwriting authority delegated to such entities is considered by OSFI to be "insure in Canada a risk".
- 5.2 As a consequence, such business is unaffected by the introduction of the AIF signing process, and no amendments to current business practices are required.

Further Information

If you require additional information or wish to discuss this matter in more detail, please contact:

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