LLOYD'S

MARKET BULLETIN

REF: Y4534

Title	Performance Management – Supplemental Requirements and Guidance
Purpose	To issue "Performance Management – Supplemental Requirements and Guidance" which consolidates various performance management related requirements and guidance previously issued to the market.
Type	Event
From	Tom Bolt, Director Performance Management Directorate
Date	23 November 2011
Deadline	Immediate
Related links	Performance Management – Supplemental Requirements and Guidance

Lloyd's has produced a new document: "Performance Management – Supplemental Requirements and Guidance". This document consolidates a number of existing requirements and guidance which have previously been communicated to the market in Market Bulletins and emails.

It is hoped that this document will assist the market by providing an easily accessible single point of reference for the requirements and guidance consolidated in the document.

Background

Lloyd's performance management framework consists of a number of elements. In particular, it includes Lloyd's requirements for business plan approval and managing agent compliance with the Minimum Standards. Lloyd's requirements relating to performance management are set out in a number of sources. The main ones are:

- The Underwriting Byelaw and the Requirements made under the Underwriting Byelaw
- Lloyd's Minimum Standards found on Lloyds.com

The Performance Management Directorate (PMD) also issues various requirements during the year to assist managing agents with meeting the business plan timetable such as the SBF Instructions issued annually by Underwriting Performance.

Lloyd's is authorised under the Financial Services and Markets Act 2000

In addition, PMD has from time to time provided supplemental requirements or guidance in relation to particular areas of business. This includes, for example, Lloyd's requirements in relation to RITC, Financial Guarantee business and War related risks.

Consolidating the requirements and guidance

Where such additional requirements have been issued they have usually been communicated in Market Bulletins or in emails to managing agents. While Market Bulletins and emails are an effective way of communicating with the market, Lloyd's recognises that this approach means that the relevant requirements are now spread out over a number of different documents, not all of which are available on lloyds.com.

PMD has therefore produced a new document called "Performance Management – Supplemental Requirements and Guidance" which is included with this bulletin and which will be available on lloyds.com.

This document consolidates and replaces the requirements and guidance previously issued to the Market which deal with underwriting performance management issues. It is intended to assist the market by providing managing agents with a single point of reference for Lloyd's supplemental performance management requirements. The document will be available on Lloyd's website and will be updated on a regular basis to ensure that the requirements and guidance remain current and relevant.

Lloyd's will continue to use Market Bulletins and emails to communicate with the market but, where appropriate, any supplemental requirements or guidance which relate to performance management will be consolidated into an updated version of this document.

Lloyd's has consulted on the text of this document with the LMA before issuing it.

Scope

The requirements and guidance set out in this document are supplemental to Lloyd's requirements as set out in Lloyd's Byelaws and Minimum Standards. While this document includes requirements that are relevant to all parts of PMD, the requirements are primarily concerned with underwriting and business plan matters.

This document does not cover delegated authority requirements, which are addressed separately, including in the Code of Practice for Delegated Underwriting. This document also does not include requirements that are specific to compliance with the Lloyd's annual timetable. These matters will continue to be dealt with in Market Bulletins.

While the document mostly consists of requirements that have been previously issued to the Market in one form or another, it does include a limited number of new additions. This includes the headings "Underwriting in the Room/Use of Lloyd's Anchor" and "General insurance contracts involving risks relating to the death of an individual". In some cases the consolidated text has been updated to reflect changes since the original Market Bulletin or email was sent out. It is important, therefore, that managing agents familiarise themselves

with the whole of the document and they should no longer rely on the previously issued Market Bulletins and emails, which are superseded by this document.

Where managing agents are in any doubt as to the application of the requirements they should raise the matter with the relevant account executive.

Further Information

Questions arising from the matters covered in “Performance Management – Supplemental Requirements and Guidance” should be addressed, in the first instance, to the relevant account executive.

LLOYD'S

PERFORMANCE MANAGEMENT –

SUPPLEMENTAL REQUIREMENTS & GUIDANCE

NOVEMBER 2011

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INTRODUCTION

This document sets out supplemental requirements and guidance that relate to performance management in the Lloyd's market.

Background

Lloyd's performance management framework provides that managing agents may only underwrite on behalf of the members of a syndicate in accordance with a business plan that has been agreed by the Performance Management Directorate (PMD). Lloyd's also prescribes a number of Minimum Standards which managing agents are expect to meet (available on Lloyds.com).

In addition, in a number of areas, PMD has issued supplemental requirements and guidance which relate to performance management issues. In a number of cases these requirements have been concerned with the underwriting of particular classes of business. In many instances, Lloyd's considers that compliance with these requirements is a matter of prudential concern for the market.

Whereas in the past, these requirements have been issued in the form of bulletins or as emails, they are now consolidated in this document. The intention of this document is to provide managing agents with a single point of reference for Lloyd's supplemental performance management requirements and guidance. It supersedes and replaces the earlier Market Bulletins or emails covering the same topics.

Scope of this document

The requirements and guidance set out in this document are supplemental to Lloyd's requirements as set out in Lloyd's Byelaws and Minimum Standards.

While this document includes requirements that are relevant to all parts of PMD the requirements are primarily concerned with underwriting and business plan matters. This document does not cover delegated authority requirements, which are addressed separately, including in the Delegated Authority Code of Practice.

This document also does not include requirements that are specific to compliance with the Lloyd's annual timetable. These matters will continue to be dealt with in Market Bulletins or emails to the market.

Where managing agents are in any doubt as to the application of the requirements or guidance set out in this document they should raise the matter with the relevant account executive.

Updates to this Document

It is intended that this document will be updated and supplemented at regular intervals.

Lloyd's will continue to communicate performance management related requirements to the Market through emails and Market Bulletins. Where appropriate, they will be consolidated into subsequent versions of this document.

APPROACH TO PERFORMANCE ISSUES

The following principles have been shared with the market and endorsed by the Franchise Board.

These follow Lloyd’s general approach to working with the market and each managing agent, taking account of individual circumstances and with the intention of responding with commercial common sense. The principles also reflect earlier messages to the market relating to the Franchise Standards implementation.

These principles were first circulated to the market at the request of the Franchise Board in July 2007 so that everyone would have a common understanding.

Monitoring & Measurement

1 The Performance Framework consists of enforceable Standards:
   a. to ensure fairness for all managing agents

2 These Standards apply to all businesses trading at Lloyd's:
   a. devised for the protection of all market sectors

3 Meeting the Standards should be 'business as usual' good practice:
   a. not a 'regulatory burden'

4 Lloyd's requires all managing agents to at least meet the minimum Standards and encourages those currently exceeding them, or planning to exceed them:
   a. Minimum Standards are a floor and not a ceiling for performance!

5 Each managing agent can choose how best to meet the stated Standards:
   a. as long as that capability can be demonstrated

6 Lloyd's will take a risk-based approach to Standards in general:
   a. taking account of the probability and potential scale of failure
   b. recognising that solutions can vary between firms with a range of scale and complexity

7 The expectations of our Regulator must always be met.

8 Standards will be periodically reviewed to ensure that they remain appropriate to the Lloyd’s market's needs. This could involve the adjustment of existing standards and the addition of new standards, in response to changing circumstances.

9 Lloyd's role is to ensure that Minimum Standards are met, while providing support and adding value wherever possible

Response to Performance

10 Consistently superior performance will be recognised:

a. within the ICA risk assessment and consequent capital requirement
b. by a lesser degree of oversight being exercised by Lloyd's
c. allowing for the agreement of more flexible business plans and for changes to those plans to be readily agreed

11 Lloyd's response to failure to meet Minimum Standards will be to:

a. engage and listen to the managing agent involved
b. establish the facts
c. protect the interests of the members of the syndicate in question, the managing agent and the market generally, acting with discretion and taking a commercial perspective
d. seek resolution via agreed action plans wherever feasible
e. ensure that any actions are fair and proportionate having regard to the level of risk to which the syndicate, the managing agent or the market are exposed (Lloyd’s has extensive options regarding under-performance using the Underwriting Byelaw, as well as through the business planning and ICA processes)

PERFORMANCE MANAGEMENT REQUIREMENTS AND GUIDANCE

Franchise Guidelines

The guidelines set out below were developed by Lloyd's to help managing agents to optimise and, where necessary, improve the performance of their syndicates. The guidelines derive from the Chairman's Strategy Group (CSG) consultation document and were arrived at following extensive consultation with the market.

Each managing agent is expected, under normal circumstances, to operate its business within the guidelines. If a managing agent wishes to operate outside the guidelines in respect of a syndicate, it will need to discuss its position and obtain a dispensation in advance from PMD.

It is not intended that the guidelines should be blindly applied to every syndicate and on every line of business. PMD will consider requests for dispensations if a robust argument can be made to justify the dispensation.

Each Franchise Guideline is stated below. This is followed, where relevant, by guidance in respect of that guideline.

(Note that with effect from the 2012 underwriting year and as set out below, a number of the Franchise Guidelines are being measured as a percentage of premium income rather than capacity. For these purposes, premium income is defined as gross net premium (GNP) which is gross written premium less acquisition costs.)

1 Profitability by product line

There should be a reasonable expectation of making a gross underwriting profit on each line of business every year.

2 Catastrophe Exposure

a. Catastrophe exposure should be analysed using tools or methods that are approved by Lloyd's.
b. Each managing agent should manage to a minimum return period agreed by the Lloyd's.
c. The maximum gross and net exposures to a single Lloyd's specified Realistic Disaster Scenario (RDS) event for a syndicate are up to 75% and 20% of syndicate gross net premium respectively.

- Guidance

In reviewing a syndicate's management of gross and net exposure to minimum return period/specified RDS events, attention will be paid not only to overall syndicate gross net premium, but also to:

- The gross net premium allocated by the syndicate to the line of business,
- The level of capital,
- The level of expected underlying profitability in the line of business absent major catastrophic events,
- The level of expected profitability in the other lines of business written by the syndicate, and the degree of inherent volatility in those other lines,
- The assumptions used in calculating RDS exposures, and
- The managing agent's capability and competence.

This is consistent with the intent of the existing guidelines, and the CSG consultation document statement that "The capacity, (and hence capital), of any syndicate should not be threatened to a considerable extent by any one RDS event. [Managing agents] cannot be allowed in future to risk unreasonable exposures to their syndicate's own capital or the Central Fund in this way".

For the sake of clarity it is emphasised that it is not the intention simply to apply guideline percentages of syndicate gross net premium to the premium allocated to the line of business, or to capital.

3 Reinsurer selection

Each managing agent should have an approved reinsurer selection process.

4 Gross line size

The maximum gross line that a syndicate should have on an individual risk is 10% of gross net premium.

- Guidance

In reviewing a syndicate's gross line sizes on individual risks for any class of business, attention will be paid not only to overall syndicate gross net premium, but also to:

- The gross net premium allocated by the syndicate to the line of business,
- The level of capital,
- The risk characteristics of the line of business, and the level of expected profitability in that line,

- The level of expected profitability in the other lines of business written by the syndicate, and the degree of inherent volatility in those other lines,
- The quality and nature of the reinsurance supporting the gross line size,
- Line size utilisation, and
- The managing agent's capability and competence.

This is consistent with the intent of the existing guidelines, and the CSG consultation document statement that "Individual risks should not be allowed to threaten large portions of a syndicate's capital".

Again, for the sake of clarity it is emphasised that it is not the intention simply to apply guideline percentages of syndicate gross net premium to the premium allocated to the line of business, or to capital.

5 Reinsurance leverage

a. Each syndicate should retain a net minimum amount of exposure on each risk (e.g. 10% of gross line).
b. No syndicate should pursue an aggressive arbitrage strategy (e.g. building business using inadequate pricing on the back of reinsurance).

- Guidance

Since the guideline refers to a minimum net retention on each risk as a percentage of the gross line, obviously the considerations detailed above in relation to gross line size, will impact the net retained line.

The key consideration as regards reinsurance leverage, (as highlighted in the CSG consultation document), is the avoidance of aggressive arbitrage, i.e. reliance on reinsurance cover to compete at uneconomically low premiums. This is also consistent with the Profitability by Product Line guideline, which states that "There should be a reasonable expectation of making a gross underwriting profit on each line of business every year."

Where there is a significant difference between the gross and net line size, the matching of reinsurance coverage to the underlying exposures, will also be an important factor in considering any variance from the guidelines. However, account will be taken of the availability of matching reinsurance.

In addition to ensuring that syndicates place their reinsurance with reputable, secure reinsurers, PMD will be keen to ensure:

- That any reinsurance arrangements shared with non-Lloyd's entities provide the appropriate level of protection and are not disadvantageous to the syndicate(s) concerned, (e.g. in terms of coverage availability, equitable sharing of premiums and reinstatement premiums etc.). (See further below – Shared Reinsurance Arrangements),
- That any finite risk reinsurance arrangements are fully transparent and provide the appropriate level of protection, and
- That undue concentrations of reinsurance with individual reinsurers are avoided or minimised.

6 Multi-year policies

a. Non-cancellable policies covering a period of greater than 18 months should be recorded as multi-year policies.

b. Multi-year policies should either have matching reinsurance cover or be limited to the agreed maximum net exposure to the class of business as set out in the syndicate's business plan.

- Guidance

Account will be taken of the availability of matching reinsurance.

Managing agents (together with their auditors, where appropriate) are responsible for deciding whether reallocation of premium is appropriate on multi-year policies (ie contracts where the overall period of risk exceeds 18 months and the costs and/or benefits under the contract may affect more than one year of account). See Market Bulletin Y3993 which includes a brief summary of the key legal and accounting principles relating to the allocation of premium.

7 Overall market dominance by a managing agent

No managing agent should write more than 15% of the overall market gross net premium without the prior agreement of Lloyd's.

Overwriting

Overwriting is writing more Stamp Gross Premium (SGP) at a whole account level than has been approved by Lloyd's for the year of account in question as stated in the most recent

SBF approval letter or where the SGP for a particular class is materially greater than that stated in the most recently approved SBF for that particular class.

The procedure for obtaining Lloyd's agreement to overwrite

If a syndicate wishes to overwrite, its Managing Agent must obtain prior approval from the Underwriting Performance (UP) team who, in conjunction with the Managing Agent, will determine if a revised SBF and ICA needs to be submitted.

Notes:

- Agents should contact their UP Executive if they require clarification as to whether a particular variance of SGP for a class of business would be considered ‘material’. The key considerations will be the size of increase and the impact on capital requirements resulting from a change in the composition of the whole account portfolio.
- The UP team use the Quarterly Monitoring Return (QMB) and form 163 of PMDR to assess the expected premium volume for the year. The UP team takes into account fluctuations in exchange rates when monitoring premium volume. This ensures that we are comparing the plan and PMDR on as consistent a basis as possible.
- The requirement to inform the UP team of overwriting is derived from the Underwriting Byelaw, which requires that Managing Agents should write in accordance with a syndicate’s approved business plan and provides that Managing Agents should notify Lloyd’s where they expect to deviate from the plan. There is also a separate requirement on Managing Agents under the Underwriting Byelaw to take reasonable steps to ensure that they do not write in excess of the syndicate’s capacity (paragraph 36).

The Implications of Overwriting

If a syndicate has identified that it may overwrite or if it wishes to obtain Lloyd's approval to overwrite, the UP team will wish to discuss the following points:

- The reasons for overwriting – i.e. due to new business, better rates, failure of controls etc.
- The effect of overwriting on the syndicate's capital requirements.
- If applicable, any franchise guideline dispensations.
- The procedure taken for notifying the syndicate's capital providers and whether their approval has been obtained.
- Whether the SBF and ICA need to be resubmitted.

Managing agents of non-aligned syndicates should note that the ability of Lloyd's to agree to any overwriting may be more limited. In particular, Lloyd's may be more constrained in agreeing to overwriting where this would require additional capital to be provided mid-year. In addition, any permission to overwrite will only be on the basis that the syndicate remains within its syndicate capacity. Lloyd's will discuss Managing Agent's options in these circumstances on a case by case basis.

Where a syndicate fails to notify the UP team that it may overwrite and subsequently the QMB, PMDR or other core market returns show that the syndicate has actually overwritten, the UP team will, in addition to the above considerations, also wish to review the effectiveness of management controls. The risk of premium volumes exceeding plan will be taken into account when approving both business plans and ICAs.

Performance Monitoring

Lloyd's uses QMB, PMDR and other core market returns to monitor several aspects of performance, one of these being the amount of SGP written. More specifically Lloyd's looks at:

- Whether SGP is in line with the approved plan and if there is a potential for overwriting compared to the plan.
- For non-aligned syndicates whether there is the potential to overwrite syndicate capacity.
- Comparison to previous years written premium development patterns.

If as a result of analysis of the QMB and PMDR, the UP team identifies that current SGP volume when trended for ultimate development is likely to exceed plan, the UP team will inform the Managing Agent accordingly and seek confirmation from them in writing as to their position. In the first instance, however, it is for Managing Agents to monitor premium volumes against their approved plans, in order to identify if they are likely to overwrite and to take appropriate action, including notifying the UP team.

Shared Reinsurance Arrangements

Managing Agents are reminded that paragraph 18 of the Multiple Syndicates Byelaw imposes restrictions on managing agents wishing to reinsure two or more syndicates managed by it under the same contract. Restrictions also apply to the reinsurance between two

syndicates managed by the same managing agent (see paragraph 19 of the Multiple Syndicate Byelaw).

In respect of all shared reinsurance arrangements (both where the benefit of the reinsurance is shared with another Lloyd's syndicate and where it is shared with a non-Lloyd's company):

1 The Managing Agent will use its best endeavours to secure a non-avoidance clause on all shared reinsurances to ensure that in the event of reinsurers entering into a dispute with a reinsured other than the syndicate, reinsurers will continue to honour their contractual obligations to the syndicate and will not seek to void the reinsurance contract with the syndicate as a result of that dispute.

2 The premium payable for all shared reinsurance will be allocated in a clearly defined and equitable manner reflecting the relative exposures of each reinsured entity.

3 Where a recovery is made under any layer of shared reinsurance, the limit(s) and deductible will be apportioned in the ratio that each reinsured's paid loss bears to the total claims paid by the syndicate and other reinsureds.

4 Where a recovery is made under any layer of shared reinsurance, reinstatement premiums will be apportioned between the syndicate and other reinsureds in the same proportion as the recovery.

5 In the event that the incurred position on the 1st layer on any shared reinsurance programme reaches 40% of the total cover available on that layer, the Managing Agent will advise Lloyd's in order to discuss the need to obtain additional protection.

6 All reinsurance is rated A- or higher by AM Best, or A or higher by Standard & Poors, unless otherwise agreed by Lloyd's. Confirmation is submitted to Lloyd's that the board of the Managing Agent is satisfied that each shared reinsurance is in the best interests of the members of the syndicate.

7 The shared reinsurances are notified to the FSA.

Related Party Transactions

As part of the business planning process, Lloyd's requires managing agents to disclose details of all transactions with related parties for each current year of account and those

envisaged for the prospective year of account. Such disclosures should also include the aggregate net underwriting results from such transactions for the current plus two previous years of account and also the planned net results for the prospective year. These requirements derive from paragraph 14A of the Underwriting Byelaw.

Since the Legislative Reform (Lloyd's) Order 2008, which repealed the divestment provisions in Lloyd's Act 1982 prohibiting associations between managing agents and brokers, the disclosure requirements in respect of related party transactions have been extended to transactions that are placed with or through a related intermediary.

A related party insurance transaction is one where the syndicate will either:

- insure, reinsure or place reinsurance with or through a related party; or
- insure, reinsure or place reinsurance with or through any person other than on an arms length basis on ordinary commercial terms.

"Through" for these purposes means through any person acting as an insurance intermediary or broker.

A related party for these purposes means –

- any company within the same group as the managing agent;
- any company within the same group as a corporate member of the syndicate which has a syndicate premium income of more than 10% of the syndicate allocated capacity;
- Any company which has two or more directors in common with the managing agent.

Group has the meaning set out in section 421 of the Financial Services and Markets Act 2000.

Each managing agent is further required as part of the business planning process to provide a statement confirming that it has systems and controls in place for dealing with related parties in order to ensure any conflicts of interest are managed fairly in accordance with applicable Lloyd's and FSA requirements (including applicable conflict management rules in Lloyd's Franchise Standards and the FSA Handbook; PRIN 2.1.1, INSPRU 8.2.6 and 8.2.7).

Although the disclosure requirements form part of the business planning process, to assist managing agents, the disclosure process is dealt with outside the normal business planning timetable and a separate request for the information is sent to the market early in each underwriting year of account when the managing will have the final details for the prior years of account.

Managing agents should note that in addition to the specific requirements for disclosure set out above there is a general requirement in paragraph 14A of the Underwriting Byelaw to disclose information relating to any association or current or proposed underwriting transaction which may give rise to a conflict of interest.

Managing agents are required to make available to members of the relevant syndicate (or their members' agents) the information referred to above. Members' agents are required to make sure this information is drawn to the attention of their members (paragraph 23A).

A managing agent which proposes to enter into a related party insurance transaction which is not disclosed in accordance with the process set out by Lloyd's, must apply to the Underwriting Performance team within the PMD before entering into the transaction in question.

Managing agents will be aware that there are separate obligations to disclose related party transactions when preparing syndicate annual accounts. So that it can prepare the Aggregate Accounts, Lloyd's also requires managing agents annually to provide details of related party transactions where the transactions are material and have not been concluded under normal market conditions. This is coordinated by the Market Finance team as part of the annual syndicate report and accounts process.

BIPAR Principles

Lloyd's wishes managing agents to conduct insurance business at Lloyd's in full compliance with European and UK competition law.

Following the publication of a final report on 25 September 2007 by the European Commission on its inquiry into the business insurance sector, the European Federation of Insurance Intermediaries (BIPAR) developed High Level Principles which are intended for use by brokers as a general guide in relation to placement of risk with multiple insurers. These principles are can be found at http://www.bipar.eu/en/key-issues-positions/principles. As part of the ongoing development of co-insurance arrangements, and in conjunction with the BIPAR High Level principles, Lloyd's wishes to remind managing agents and their underwriters of their obligation to comply with competition law and, in particular, that –

1 Brokers must seek to place business as they see fit having regard to the interests of their client. That may involve brokers inviting following underwriters to subscribe to a risk on identical contractual terms and conditions as the lead underwriter other than premium.

Where underwriters receive such an invitation, they should give careful, independent consideration to it. Following such independent consideration, the underwriter may decide to quote or subscribe to the risk at a different premium from the lead underwriter or, as with any risk, decline to quote or subscribe to it.

2 In any co-insurance placement, underwriters may, but are not obliged to, follow the premium charged by the lead underwriter;

3 Underwriters should not use 'best terms and conditions clauses" or engage in market practice which has the same effect unless they have first obtained legal advice that the use of such a clause or practice would be lawful and contract certain in the circumstances of a particular case. The Commission's definition of such clauses is as follows –

"*any stipulation, whether written or oral, introduced at any stage of the negotiation of a reinsurance contract, by means of which a (re)insurer A obtains, seeks to obtain or acquires the right, under certain circumstances, to obtain an alignment of its proposed or agreed terms and conditions, in particular the premium, to the terms and conditions ultimately obtained by any other (re)insurer B participating in (re)insuring the same (re)insured as A, in the event that the latter terms are more favourable to the (re)insurer, than the terms and conditions which A offered or subsequently agreed.*"

Reinsurance to Close

Documentation of RITC Contracts

Managing agents closing open years of accounts of syndicates under their management must ensure that any reinsurance to close is properly documented in a Contract of Reinsurance to Close. This requirement applies to all syndicates closing years of account where there is more than one member of the syndicate on either the reinsuring year or on the reinsured year. This also applies where both the reinsuring and reinsured year consists of a single member but where the legal identity of the reinsured and reinsuring member is different.

Where the syndicate has one member which is the only member on both the year of account that is being closed and on the year of account into which the open year is being closed, no reinsurance to close is required. The managing agent of the syndicate must, however, ensure that it complies with all other accounting and Lloyd's requirements for closing syndicate years of accounts.

Mandatory terms in contracts

Every contract of reinsurance to close underwritten by members of a syndicate shall, unless the Lloyd's otherwise agrees (whether generally or in relation to a particular case) include express terms to the following effect –

1 the reinsuring members unconditionally agree to indemnify the reinsured members, without limit as to time or amount, in respect of the net amount of all known or unknown losses, claims, refunds, reinsurance premiums, outgoings, expenses and other liabilities (including extra-contractual obligations for punitive or penal damages) arising in relation to the underwriting business of the syndicate for the reinsured year of account (and earlier years of account of the same or any other syndicate reinsured to close into that year of account) (the "underwriting business") after taking account of all amounts recoverable by the reinsured members under syndicate reinsurances in respect of those liabilities and actually recovered on or after the inception date of the contract;

2 notwithstanding that the indemnity under the contract is against liabilities net of syndicate reinsurance recoveries or that the ultimate net liability of the reinsuring members may not yet have been ascertained, the reinsuring members shall discharge or procure the discharge of the liabilities of the reinsured members;

3 either:

a. the rights to receive all premiums, recoveries and other monies recoverable at any time in connection with the insurance business of the reinsured members are assigned to the reinsuring members by the contract or are to be assigned on their subsequent request; or

b. the reinsuring members are authorised by the reinsured members to collect on behalf of the reinsured members the proceeds of all such rights and retain them for their own benefit so far as they are not applied in discharge of the liabilities of the reinsured members;

4 the reinsuring members are required and fully, irrevocably and exclusively authorised on behalf of the reinsured members to conduct the underwriting business, and

authorised to sub-delegate that authority to the reinsuring members' managing agent and to any person underwriting any RITC of the reinsuring members and to permit the further sub-delegation of the whole or part of that authority in either case; and

5 the contract shall not be cancelled or avoided for any reason, including mistake, non-disclosure or misrepresentation (whether innocent or not).

Multi-reinsurer contracts

No contract of RITC may be underwritten by more than one syndicate except:

1 in the case of a contract where the reinsuring syndicates are parallel syndicates; or

2 where Lloyd's is satisfied that it is not practicable for the contract to be underwritten by a single syndicate only and that the contract should be permitted to be underwritten by more than one syndicate and grants its consent.

Consent granted under paragraph 2 may be subject to such conditions as Lloyd's thinks fit.

Partial Reinsurance

Partial RITC involves leaving a year of account open but paying forward a premium to the following year of account by way of reinsurance in respect of that part of the account which the managing agent considers to be readily quantifiable. Partial RITC is not permitted.

Prohibition of Certain Exclusion Clauses

Where the RITC is to be provided by a syndicate other than a later year of account of the same syndicate ("third party RITC"), potential RITC providers have to inspect accounts and records of the closing syndicate and to ask questions of its managing agent to enable themselves to assess and quote an appropriate premium for the RITC. RITC providers therefore need to be able to rely on what is said to them by managing agents in reply to questions, particularly so where the normal duty of disclosure and the remedy of avoidance for non-disclosure do not apply. Moreover, RITC providers need to be able to rely on replies to such questions without having to load the RITC premium, at the expense of the members of the closing syndicate, to cover the risk of any negligent misrepresentation or misstatement by the closing syndicate's managing agent.

The managing agent of the closing syndicate is not permitted to exclude its duty to its members not to make negligent misrepresentations which might result in the avoidance of reinsurances placed on their behalf. No more so should it be permitted to exclude any reliance by a RITC provider on the managing agent's replies to questions or to exclude any duty of care to the potential RITC provider in replying to questions or any remedy in damages for breach of that duty.

Accordingly RITC contract wordings shall not include clauses which:

1 exclude any reliance by the reinsurer on anything said by the managing agent of the closing syndicate in relation to the contract; or

2 exclude any liability on the part of the managing agent of the closing syndicate for any negligent misrepresentation or misstatement made by the managing agent in relation to the contract.

Nothing in this part is intended to alter the requirement set out above that all RITC contracts should include an express term to the effect that the contract shall not be cancelled or avoided for any reason, including mistake, non-disclosure or misrepresentation (whether innocent or not).

Special Termination/Downgrade and Funding Clauses

It is recommended that managing agents should have a clear policy on what, if any, downgrade clauses and their component parts are acceptable to them.

When considering what downgrade clauses might be acceptable, managing agents should consider and assess the potential risks to the Lloyd's franchise as a whole which may arise as a result of their use.

As a minimum, any policy should provide that, as a rule, the managing agent:

- Will not accept provisions in clauses that, when triggered, require that the syndicate provides collateral for liabilities. It should of course be noted that in a number of territories Lloyd's syndicates already have in place funding or collateralisation arrangements, including through Lloyd's trust funds, to meet local regulations;

- Will not agree to provisions that lead to the returning of earned premium. Premium will not always be deemed to be earned on a proportionate basis. LMA 5140 is an example of a clause that may be used where premium is earned disproportionately, for example on seasonal catastrophe business. Managing agents should also consider their policy on returning premium where a loss has been paid.
- Will only agree to clauses that have a minimum trigger that is considered appropriate by the managing agent. One approach is to require that the clause is triggered only if the rating falls below a minimum rating (such as A-).

Any downgrade clauses used on inwards business should be clear and contract certain.

We recognise that there will be cases where a managing agent will not be able to achieve its requirements for special termination/downgrade clauses. A record, however, should be kept of all exceptions.

Managing agents are encouraged to develop more detailed policies as appropriate for their syndicates. The above points we believe reflect an appropriate and prudent minimum requirement.

Managing agents may wish to consider using the LMA model downgrade clauses (LMA 5139 and LMA 5140). While managing agents may, of course, use whatever clause they see fit, they should give careful consideration to the operation of the clause selected to ensure that the prudential risk is properly managed and that, where relevant, it addresses the same issues as those addressed by LMA 5139 and LMA 5140.

The consideration used in selection of any downgrade clause used should be properly documented. Lloyd’s may wish to review managing agents' documentation to assess the risk to syndicates and to the market as a whole.

(Note that the Lloyd’s Market Association’s issued Letter LTM09-025-KJ on 6 October 2009 which should be read together with the requirements set out in this section.)

General insurance contracts involving risks relating to the death of an individual

It is a UK regulatory requirement that managing agents must not permit both general insurance business and long term

insurance business (which includes all life insurance) to be carried on together through any syndicate managed by them. It is also a requirement that amounts received or receivable in respect of general insurance business and long term business must be carried to separate premium trust funds.

A number of policies are written by general syndicates in the A&H and contingency market where the contract, amongst other covers provided, may be triggered by the death of an individual (other than accidental death). Typically, in conjunction with other causes of financial loss, these products provide an indemnity for a contractual loss suffered by the insured arising from the death of a named individual. For example, a contingency policy may include cover for a concert promoter for the cost of cancelling an event as a result of the death of the performer.

The particular features of these policies mean that extra care must be taken to ensure that the risks written are appropriate for a general insurance syndicate.

To evidence compliance with the relevant FSA regulations, Lloyd's anticipates that managing agent wishing to write this type of risk will continue to ensure they have suitable legal advice confirming that the business may properly be written by a syndicate writing general insurance business. In obtaining any legal opinion the managing agent should provide copies of its standard contract wordings for review.

Where the risks are located in overseas territories which are the subject of local regulation, managing agents must additionally ensure compliance with the equivalent local regulatory requirements.

Political Risk & Credit Claims Statement of Best Practice

Following discussions between managing agents, the LMA and Lloyd's, a Statement of Best Practice has been developed for the handling of political risk and credit claims, in conjunction with the applicable Lloyd's Claims Scheme. Lloyd's supports this Statement of Best Practice, which is consistent with Lloyd's Claims Management Principles and Minimum Standards and is appended at Appendix 1.

In any reviews of managing agents' claims handling by Lloyd's, including when assessing whether managing agents meet Lloyd's Claims Management Principles and Minimum

Standards, Lloyd's will have regard to this Statement of Best Practice.

Market Reform Contracts/Contract Certainty

Market Reform Contract

The Franchise Board has mandated through the Underwriting Requirements (paragraph 3A) that:

1 Managing agents shall not permit the syndicate stamp of a syndicate managed by it to be affixed to any slip which relates to a contract or contracts of insurance unless:

a. the slip is in the form of the Market Reform Contract and the information contained in the slip has been properly completed in accordance with the relevant London Market Group guidance;
b. the slip has been marked "MR Exempt – Client Requirement"; or
c. the slip relates to motor business, personal lines business or term life insurance business and the slip will not be processed by Xchanging Insurance Services.

2 Managing agents shall not permit the syndicate stamp of a syndicate managed by it to be affixed to any slip which relates to a binding authority or to any line slip unless the slip has been completed in accordance with the relevant slip guidelines issued by the London Market Group.

Managing agents can find details of the applicable guidelines and details of the Market Reform Contract on the London Market Group website: www.londonmarketgroup.co.uk.

Contract Certainty

The contract certainty project began in December 2004 with an FSA challenge to the UK insurance industry to end the "deal now, detail later" culture. The industry took steps to improve the way it develops and agrees contracts ensuring that the insured has greater certainty over what it has bought and the insurer greater certainty over what it has committed to. Contract certainty has brought operational improvements across the Lloyd's market and wider industry, reducing risk and improving service. Contract certainty applies to general insurance contracts either entered into by an FSA-regulated insurer, or effected through an FSA-regulated intermediary. Contract certainty is achieved by the

complete and final agreement of all terms between the insured and insurer by the time that they enter into the contract, with contract documentation provided promptly thereafter.

The Contract Certainty Code of Practice 2007 was produced by the Contract Certainty Steering Committee, a cross-market committee, and has been endorsed by all the UK's leading insurance market bodies. All managing agents are expected to note and comply with the Code of Practice.

The Code of Practice can be downloaded from www.londonmarketgroup.co.uk.

Several Liability Clauses

It is of the utmost importance that all insurance and reinsurance documentation issued for or on behalf of underwriters includes an appropriate several liability clause. LMA 3333 in particular has been drafted for use by Lloyd's underwriters and is suitable for use on all contracts.

In the case of binding authority business Lloyd's has issued guidance which permits the use of alternative several liability clauses both for combined certificates and where the risk is written solely by Lloyd's underwriters. Lloyd's has issued Market Bulletin Y4133 which sets out guidance on the use of combined certificates and several liability clauses in certificates issued under binding authority agreements. The London Market Group website (www.londonmarketgroup.co.uk) also includes a Several Liability Decision Chart showing which several liability clause should be used in each case.

Underwriting Stamp/Use of Lloyd's Anchor

The use of Lloyd's underwriting stamps, including the use of the Lloyd's anchor, is a part of the Lloyd's brand. Their proper use is also important in identifying where bureau processing through Xchanging In-Sure Services Limited is required.

Stamps put down by syndicates/consortia

Stamp Format

The following requirements for the preparation and use of Lloyd's stamps have been issued by Xchanging and managing agents are asked to comply.

1 Stamps should not be in excess of 7.5cm wide.

2 Each syndicate number and its unique pseudonym should be shown. The size of typeface for each should be approximately 5mm in height.

3 Each stamp should bear a Lloyd's anchor symbol.

4 Where a syndicate number appears on a slip more than once by way of a separate stamp, an anchor symbol and a pseudonym should be shown against each syndicate number to identify it as a Lloyd's syndicate.

5 If a syndicate number is written on a slip the following should be inserted adjacent to the number:
a. the unique pseudonym
b. an anchor symbol

6 In the case of multiple stamps, a bracket is added to clarify its interpretation.

7 A bold horizontal line should be at the foot of the stamp to separate one syndicate stamp from the next.

Consortia

There are two methods of expressing underwriters' lines for consortia as follows:

<u>Syndicate Stamps</u>

All syndicate lines comprising a consortium should be shown individually on one stamp, this will be shown on slips by the leading underwriter of the consortium at the time of placing. This type of stamp is used where the number of syndicates involved is small and is called a 'Joint Stamp Basis'. The layout of these stamps should:

- Conform to standard requirements as detailed in the stamp format above.
- Show the title of the group at the top of the stamp.
- Show the subscribing percentage, syndicate number, pseudonym and underwriter's reference for each participating syndicate.

Reference Number

In this method the constitution of a consortium is registered at Xchanging Ins-sure Services and the leading syndicate uses a stamp on the slip to show the reference number and consortium name. This method is appropriate for consortia comprising many syndicates or where a request is made for a 'consortium number' by the underwriters.

The stamp should conform to the same standard requirements as normal syndicate stamps but will show the name of the consortium, reference number and anchor symbol. The stamp should also incorporate the phrase 'All underwriters as per LPSO Registered Consortium No 9XXX' below the reference box

It is not customary to show syndicate numbers on the stamp. However, if the leading syndicate requests this it should be shown in small print.

Stamps put down by other entities (including third party coverholders not writing under 9000 series consortia, service companies etc)

Only stamps which include the anchor symbol will be acceptable as valid on contracts which are to be processed through Xchanging Ins-sure Services.

Underwriting stamps where monies will be settled with the entity responsible for putting down the stamp should not include the anchor symbol.

Stamps put down by other entities should:

1 show the name of the entity responsible for putting the stamp down,

2 specifically identify the syndicate(s) and, where applicable, company(ies) responsible for insuring the risks on which the stamp appears (for example, '…underwriting on behalf of: 50% syndicate 123, 25% syndicate 456, 25% company ABC'),

3 clarify whether bureau processing is or is not required for risks upon which the stamp appears (for example, 'Premiums and claims to be settled direct with [name of entity]' or 'Premiums and claims to be settled with insurers via XIS/XCS'),

4 and, include the UMR or bureau signing number and date of the binding authority held by the entity responsible for putting down the stamp.

Stamp Approval

With regard to production of new underwriting stamps, syndicates and any entities putting down stamps on their behalf will need to make arrangements with their own suppliers. The format of these stamps will, as customary, have to be approved by Xchanging Ins-sure Services. Failure to seek approval before ordering or using a stamp may delay premium signings. Enquiries should be directed to XIS Business Support via the Xchanging Service Centre on 0870 380 0830 or email: servicecentre@xchanging.com.

Underwriting in the Room

Lloyd's Property Services is responsible for the allocation of space, including allocating boxes, in the Underwriting Room (Darren Cox – email: darren.cox@lloyds.com; tel: 020 7327 6636). Each application will be considered in accordance with Lloyd's criteria from time to time and subject to the availability of space in the Room. In the case of new Lloyd's managing agents the allocation of space in the Room is decided with the involvement of the Lloyd's Relationship Management team.

All market participants underwriting in the Underwriting Room must make clear on whose behalf they are underwriting. In particular, underwriters writing in the Room on behalf of non-Lloyd's companies (or vice-versa) should ensure that it is made clear to brokers on whose behalf they are underwriting.

Where a box is allocated on a gallery for the underwriting of syndicate business, company business should not be written at the box. Where a box is allocated on a gallery on the basis that only a certain proportion of the business written will be company business, the company business written at that box should not exceed the proportion agreed. Where Property Services become aware that company business is being written at a box, other than as agreed, the managing agent's allocation of the box may be removed.

Firms connected with the Lloyd's market that wish to have Lloyd's passes issued to individuals employed by the firm should contact Lloyd's Property Services (Trevor Smith - email: trevor.smith@lloyds.com; tel: 020 7327 6300). Passes will be allocated in accordance with Lloyd's criteria from time to time. In the case of any person who wishes to be admitted to the premises of the Society to conduct insurance business, Lloyd's requirements for the issuance of Lloyd's passes are as set out in the Annual Subscribers Byelaw.

CLASSES SUBJECT TO SPECIAL APPROVAL

War Related Classes

It has long been recognised that the uncontrolled underwriting of war, civil war and related perils is a material source of prudential risk to Lloyd's. Because of the nature of the events insured against, there is a particular risk that the aggregate losses could threaten the market's financial position.

Definition

For the purposes of this section, the term "war, civil war and related perils" includes war, civil war, invasion, act of foreign enemies, hostilities (whether war be declared or not), rebellion, revolution, insurrection, military or usurped power. Other terms are used by some managing agents to refer to the same or equivalent perils. Except as set out in the section dealing with exempted classes, all policies providing coverage for any of these or equivalent perils are subject to the provisions of this bulletin.

Business Plan Approval

In view of the prudential risks that arise across all classes of business (other than those specified below as exempt classes), syndicates may not underwrite war, civil war or related perils without the prior approval of Lloyd's through the business planning process. Managing agents wishing to write these perils should provide in their business plans the following information:

1. Classes of business to be written where coverage is in respect of or includes war, civil war and related perils.
2. The maximum gross and net line size for each class of business identified in 1. above.
3. The forecast premium income for each class of business identified in 1. above
4. The maximum policy period that will be written.
5. A breakdown of exposure by policy period where the period is in excess of 12 months.
6. The maximum territorial gross and net limit that the syndicate will write to in respect of fixed property.
7. A narrative description of the syndicate's overall approach to the underwriting of war business across all relevant classes in order to manage the overall exposure and the approach

for each class identified in 1. above. This should include details of how territory is defined for the purpose of territorial limits in respect of fixed property and a narrative description of how coverage in respect of moveable property (marine, aviation and the like) and people (accident and health and life) are taken into account in considering the syndicate's overall exposure. It should also include a narrative description of the systems and processes used by the syndicate for the monitoring and control of aggregate exposure to war, civil war and related perils.

8 Details of the approach to reinsurance. This should include details of any reinsurance that does not inure to the original cover provided (including any reinsurance that is not "matching" i.e. where the reinsurance does not provide protection for the full original policy period).

All the above information should also show broken out within it details of all war, civil war and related perils coverage where there is cover for loss arising from any element of nuclear, chemical, biological and radiological weapons of mass destruction.

Monitoring and control of exposure

Managing agents are required to demonstrate that they are monitoring and controlling the exposure of their syndicates to war, civil war and related perils. This is reviewed by Lloyd's through the business plan process (see the previous section above) and through the RDS process.

Documentation of coverage/exclusions

Managing agents should ensure that they clearly document the scope of any war, civil war and related perils cover provided.

Where cover is not provided, managing agents should ensure that a suitable exclusion clause is included in the policy terms and conditions. A number of model clauses have been developed by the LMA for this purpose.

Where cover is to be given, the scope of cover should be clearly stated either in a separate policy or in a separately identifiable section of the policy. A number of model clauses have been developed by the LMA for certain classes that specifically provide for extended coverage, such as personal accident. Model clauses have also been developed by various market committees in the marine and aviation markets.

Managing agents should not seek to provide cover merely by omitting a suitable exclusion clause ("remaining silent") in view of the risk that a court may decide the scope of cover

to be wider than that intended. In classes where underwriters wish to remain silent on war, civil war and related coverage this needs to be made clear in the syndicate business plan as part of the syndicate business plan approval process and a clear rationale will be required.

The above approach to documenting the scope of cover applies to both insurance and reinsurance business.

Delegated underwriting

The underwriting of war, civil war and related perils by coverholders is permitted but, in the case of war on land risks (risk code WL), only where each risk is subject to the agreement of the leading Lloyd's underwriter prior to binding ("prior submit"), unless specific approval has been obtained from Lloyd's. Following underwriters should ensure that there are arrangements in place to provide them with prompt advice of exposure assumed under such delegated authorities.

Exempted Classes

The requirements of this bulletin do not apply to Directors' and Officers' Liability, Professional Indemnity, Legal Expenses and Workers' Compensation classes which are recorded to risk codes D2 to D5, E2 to E9, F2 and F3, LE, W3 to W6. In addition, the requirements do not apply to motor classes which are recorded to risk codes M2 to M6, MF, MH, MI and MP to the extent that cover is provided to meet statutory requirements for coverage. Lloyd's is satisfied that in these classes the prudential risk does not merit the additional level of monitoring.

Regarding the documentation of cover in these classes, while managing agents do not need to comply with the specific requirements detailed above, to the extent that cover is provided for war, civil war and related perils due regard should be given to the drafting of the policy to ensure that it is contract certain.

NCBR Cover

The uncontrolled underwriting of business exposed to losses resulting from nuclear, chemical and biological weapons and weapons involving the emission of radioactive matter (NCBR) is a material source of prudential risk to Lloyd's across all classes. Close monitoring and control of aggregate exposures is therefore required. Losses arising from the use of NCBR weapons can occur as result of war,

civil war and related perils. They can also arise from terrorism incidents.

NCBR Weapons

The following requirements apply to underwriters' exposures to all acts of aggression involving the use of NCBR weapons.

1 All insurance and reinsurance policies should contain a clause or clauses excluding all losses caused by the detonation of a nuclear weapon and the release of harmful chemical and biological agents and radioactive matter except where such exclusions contravene local legal or regulatory requirements or where syndicates have Lloyd's express approval (see 2. below). The LMA has long had available a number of model clauses excluding nuclear and radioactive contamination losses and CL 370 (Institute Exclusion) is an example of an clause excluding loss caused by other NCBR weapons.

It is important to ensure that, where policies are specifically extended to cover war, civil war and the like, the wording of the extension does not override any NCBR exclusion contained within the policy.

2 Syndicates may not underwrite NCBR perils without the prior approval of Lloyd's through the business planning process. Managing agents seeking approval will be required to demonstrate that they are able to monitor and control effectively the exposures to be written. While Lloyd's believes that current syndicate exposures fall within acceptable tolerance limits, the difficulty in evaluating the perils and monitoring the accumulation exposure from different policies means Lloyd's would have prudential concerns if the current levels of exposure to the market were to increase materially and this will be taken into account when business plan approval is being considered.

3 Where approval has been given for a syndicate to cover NCBR perils managing agents should not seek to provide cover merely by omitting a suitable exclusion clause ("remaining silent") in view of the risk that a court may decide the scope of cover is wider than that intended. The LMA has developed model clauses for use with Personal Accident insurance and reinsurance policies (LMA 5117 and LMA5118) that specifically provide for the write back of such extended coverage and are examples of appropriate clauses.

It is not necessary for managing agents to obtain specific business plan approval for the provision of NCBR coverage where it is required by local laws or regulation such as that

required under certain strict liability legal regimes. This exemption does not extend to the non-compulsory underwriting of NCBR risks such as reinsurance of the French GAREAT pool. Even where specific Lloyd's approval is not required, managing agents should ensure that they monitor and control their aggregate exposure to NCBR coverage given as a result of local laws or regulation and that it is reported in their Syndicate Business Plans.

Civil nuclear incidents

The requirements contained in the above section do not apply to the underwriting of civil nuclear incidents. Most of such coverage is currently provided by insurance pools and industry mutuals, which may be reinsured by Lloyd's underwriters. This business currently forms a discrete specialist class the underwriting of which is approved in the business plan process. Managing agents underwriting this class should nevertheless satisfy themselves that the exposure generated by participation in the pools, reinsurance of pools and industry mutuals, when aggregated with ancillary coverages such as personal accident catastrophe reinsurance of life companies, falls within their business plans.

Financial Guarantee

In view of the risk that Financial Guarantee insurance creates for the market, and subject to the usual requirements for business plan approval, no managing agent may enter into a contract of Financial Guarantee insurance (as defined below in Part I) on behalf of a syndicate under its management unless either:

- The contract falls within one of the "exempted classes" as set out below in Part II and the associated definitions set out in Part III and the principles contained in Part IV are complied with; or
- The contract has been specifically approved by Underwriting Performance.

Managing agents seeking approval to write Financial Guarantee insurance which does not fall within one of the "exempted classes" should discuss their proposals with their account executive in the Underwriting Performance team as part of the business planning process.

Where a managing agent is considering a risk but is uncertain as to whether it falls within the definition of Financial Guarantee insurance or one of the exempted

classes, it should discuss it with its account executive in the Underwriting Performance team.

Premium Income Limits

The PMD will consider all business plans that propose to include Financial Guarantee insurance (including the exempted classes) individually. By way of general guidance it is unlikely that business plans will be approved where the income arising from the "exempted classes" amounts to more than 2% of syndicate allocated capacity other than trade credit business where the relevant percentage figure is 5%, i.e. 7% in total.

Part I: Definition of Financial Guarantee Insurance

Financial Guarantee insurance is defined as contracts of insurance (which includes any indemnity, guarantee, bond, contract of surety or other similar instrument, and references to "insurance" includes reinsurance) where the insurer agrees to indemnify the insured against loss or pay or otherwise benefit the insured in the event of:

1. the financial failure, default, insolvency, bankruptcy, liquidation or winding up of any person whether or not a party to the contract of insurance; or
2. the financial failure of any venture; or
3. the lack of or insufficient receipts, sales or profits of any venture; or
4. the lack of or inadequate response or support by sponsors or financial supporters; or
5. a change in levels of interest rates; or
6. a change of rates of exchange of currency; or
7. a change in the value or price of land, buildings, securities or commodities; or
8. a change in levels of financial or commodity indices; or
9. any liability or obligation under an accommodation bill or similar instrument.

Part II: Definitions of the Exempted Classes

Terms shown in italics are defined in Part III below.

A. Contract Frustration (Risk Code "CF")

1 Contract Frustration insurance indemnifies an insured for loss under:

a. a specified contract or contracts for the sale, purchase, lease or delivery of assets, goods or services; or
b. an agreement which relates directly to the financing of such specified contract(s); or
c. an agreement concerning financing which is secured against assets, goods or services and/or payment for assets, goods or services due under a specified contract or contracts, or where repayment is to be effected by the sale or receipts of such goods or services, or assets, royalties or other specified receivables; or
d. a *Bond* or *Bonds* provided in accordance with the terms of a specified contract, tender document or project;

2 due directly to one or more of the following perils:

a. a *Political Force Majeure event*; or
b. an event resulting directly or indirectly from the actions, inactions and/or default, of a *Supra-National Authority*, or *Government Entity*, including the inability to make a currency conversion and/or exchange transfer. Such actions may also include default of a *Government Entity* which is guaranteeing the performance of either another *Government Entity* or of a *Commercial Organisation*.

3 Contracts that are permissible within section A.1 may also include *Bonds* which are provided in connection with eligible contracts, concession agreements and *Project Finance*. However, coverage for such contracts may, where appropriate, be provided by policies which are classified as other classes of business subject to compliance with any requirements in relation to those classes.

4 For a contract to be eligible for inclusion under A.1(c) above it must:

a. directly finance a specified trade contract; or
b. be repaid from identified and assigned or assignable trade flows; or
c. be secured upon identified collateral or assets.

5 Under no circumstances should Contract Frustration policies cover:

a. Contracts for which the purpose is the provision of working capital or general corporate lending unless such contracts fall within the provisions of 1 above; or
b. *Acquisition Finance*; or

c. *Sovereign Lending*; or
d. Currency fluctuations and/or devaluations.

6 Insureds acting in a lending capacity may also be indemnified under Contract Frustration insurance where they are the beneficiary of a policy protecting against *Lender's Interest* risks in accordance with the provision set out in the definition of *Lender's Interest* in Part III, paragraph 7.

7 Contract Frustration insurance may cover currency inconvertibility and/or exchange transfer risks when there is no specified contract of sale, purchase, lease or delivery of goods, assets or services. However such cover shall not be designed or intended to be used for the purpose of currency speculation or trading. Except where the risk is Trade Credit, any section of a policy that covers currency inconvertibility and/or exchange transfer risks shall be considered as Contract Frustration insurance.

8 Where the currency of the insurance policy and the currency of the specified contract(s) are different, underwriters shall establish the mechanism by which the applicable rate of exchange to be used for the calculation of an insured loss will be determined.

B. <u>Trade Credit (Risk Code "CR")</u>

1 Trade Credit insurance indemnifies an insured for loss under:

a. a specified contract or contracts for the sale, purchase, lease or delivery of assets, goods or services; or
b. an agreement which relates directly to the financing of such specified contract(s); or
c. an agreement concerning financing which is secured against assets, goods or services and/or payment for assets, goods or services due under a specified contract or contracts, or where repayment is to be effected by the sale or receipts of such goods or services, or assets, royalties or other specified receivables; or
d. a *Bond* or *Bonds* provided in accordance with the terms of a specified contract, tender document or project;

due directly to the actions, inactions and/or default by a *Commercial Organisation*.

2 Contracts that are permissible within section B.1 may also include *Bonds* which are provided in connection with eligible contracts, concession agreements and *Project Finance*. However, coverage for such contracts may, where appropriate, be provided by policies which are classified as

other classes of business subject to compliance with any requirements in relation to those classes.

3 For a contract to be eligible for inclusion under B.1(c) above it must
- a. directly finance a specified trade contract; or
- b. be repaid from identified and assigned or assignable trade flows; or
- c. be secured upon identified collateral or assets.

4 Under no circumstances should Trade Credit policies cover:
- a. Contracts made by the insured with private individuals (other than sole traders operating in their business capacity); or
- b. *Mortgage Finance* Insurance; or
- c. Contracts for which the purpose is the provision of working capital or general corporate lending unless such contracts fall within the provisions of B.1 above; or
- d. *Acquisition Finance*; or
- e. Currency fluctuations and/or devaluations (but see the provisions of A.7 above).

5 Where the currency of the insurance policy and the currency of the specified contract(s) are different, underwriters shall establish the mechanism by which the applicable rate of exchange to be used for the calculation of an insured loss will be determined.

6 Insureds acting in a lending capacity may also be indemnified under Trade Credit insurance where they are the beneficiary of a policy protecting against Lender's Interest risks in accordance with the provision set out in the definition of Lender's Interest in Part III, paragraph 7.

<u>Application of risk codes</u>

Where financial default and insolvency is a covered cause of loss under policies described in section A and B above, underwriters must apply the appropriate CF and CR risk codes according to whether the obligor is considered to be public or private and give proper consideration to the appropriate apportionment of premium in respect of any policy which covers both Contract Frustration and Trade Credit perils.

C. <u>Mortgage Indemnity Insurance (Risk Code "FM")</u>

Mortgage Indemnity Insurance indemnifies a bank or other lender who has provided a loan to a borrower only where the loan is used to purchase a commercial or residential property (which shall mean a building and not, for example, a ship or aircraft) and where this property is mortgaged to the bank or lender as security for the loan. Mortgage

Indemnity Insurance responds if a shortfall remains between the amount of the loan and the proceeds realised from disposal of the mortgaged property following repossession.

D. Surety Bond Reinsurance (Risk Code "SB")

1 Surety Bond Reinsurance indemnifies a surety bond provider against the failure by the party (obligor) whose contractual obligation is the subject of the surety bond to execute a specified contractual obligation to the third party (obligee) identified on the surety bond.

2 Lloyd's underwriters' participation in such business is limited to the reinsurance of non-Lloyd's entities which are licensed surety bond providers.

E Salvage Guarantee Insurance

Collision, salvage and general average guarantees indemnify against the failure of a guarantor to perform its obligations under various forms of marine guarantees.

Part III: Definitions of Italicised Terms used in Part II

1 Political Force Majeure

Riots, strikes, civil commotions, malicious damage, sabotage, terrorism, war, invasion, acts of foreign enemies, hostile action by national or international armed forces (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power, or other similar events.

2 Supra-National Authority

A multi-national (also known as a "multilateral") institution (e.g. the United Nations, the International Monetary Fund or the European Union) which has a ruling body whose controlling interest is held by government ministers, or formally appointed representatives, of member states.

3 Government Entity

A "Government Entity" must conform to at least one of the following criteria:

a. a Central Government or a Ministry, Department or Agency thereof (hereinafter referred to as "Government");
b. a Regional or Local Authority or a Department or Agency thereof (hereinafter referred to as "Local Authority");
c. a Nationalised Undertaking, including a Public Corporation or a State Trading Organisation or an entity in which the Government of the country(ies) concerned

or Local Authority(ies) retain(s) a controlling interest or a majority shareholding; or

d. a central bank or other equivalent monetary authority.

In the event of a Government Entity obligor ceasing to conform to one of the above criteria during the currency of the policy period, then underwriters may maintain coverage on original terms and conditions at their sole discretion until the expiry of the original policy.

4 Sovereign Lending

Any loan or other transaction or activity for the provision of finance and any guarantee or indemnity in respect of such transaction or of any other financial obligation into which a *Government Entity* enters other than for an identified trade or *Project Finance* or which is secured upon a commodity, asset, royalty or other specified receivable.

5 Project Finance

The provision of any loan or an agreement concerning financing for a specific project.

6 Commercial Organisation

Limited companies, public limited companies, partnerships, and sole traders, which may include banks or financial institutions, but none of the foregoing may include a Government Entity.

7 Lender's Interest

Lender's Interest insurance shall be limited to a Policy which indemnifies against default or non-(re)payment by a Commercial Organisation on a loan, whether or not there is a specified trade contract, where the default or non-(re)payment is directly caused by one or more of the following perils:

a. an expropriatory act;
b. arbitration award default where the award is to remedy an insured expropriatory act or licence cancellation;
c. a *Political Force Majeure* event;
d. prevention of currency conversion and/or exchange transfer;
e. embargo/licence cancellation;
f. other Contract Frustration perils as may be agreed.

However, Lender's Interest policies must not cover non-performance by the borrower or non-payment of the loan except where the non-performance or non-payment directly arises from the perils specified above.

Underwriters should give proper consideration to the risk coding of business written. In particular, currency inconvertibility/exchange transfer exposures should be coded “CF”. However, this shall not preclude the use of the applicable risk codes for the other perils mentioned above.

8 Bonds

For the purposes of Contract Frustration and Trade Credit insurance as set out in sections A and B of Part II, bonds shall be defined as guarantees, including on demand bank guarantees and standby irrevocable letters of credit issued or counter-guaranteed by banks, guaranteeing the performance of specified obligations of an insured in favour of another party to whom the obligations are owed under the terms of the contract or tender to contract.

9 Acquisition Finance

A loan or other form of funding for the purchase of shares or other ownership interest in a company or business for which the anticipated principal method of repayment arises from the revenues and/or assets of the acquired entity.

Part IV: Principles for Exempted Classes

All policies which fall within the scope of the exempted classes as set out in Part II should include in the policy wording terms which meet the following requirements. Managing agents should only omit or vary terms to this effect if they have received approval to do so through the business planning process.

1 Assignment of Policy

All policies should contain a condition that only allows assignment of the policy with the prior written agreement of underwriters. Where assignment of a policy does take place, the obligations placed upon the original insured by the terms of the policy should be transferred so that they become obligations of the assignee.

It is acceptable to allow for the proceeds of a policy to be paid to a third party provided that the obligations on the insured under the terms of the policy remain with the insured.

2 Insolvency of the Insured

All policies should contain an exclusion in respect of any loss arising from the insolvency of the Insured or, in the case of *surety bonds*, the obligee.

3 Fraud

All policies should contain a clause to the effect that the policy will become void, and all claims thereunder will be forfeited, if the insured has made any material statement, report, application or claim, where the Insured knew that the statement, report, application or claim was false or fraudulent.

4 Nuclear, Biological, Chemical and Radioactive Contamination

All policies should contain an exclusion in respect of any loss arising from or contributed to by the use of nuclear, biological, chemical weapons and radioactive contamination.

Term Life

Lloyd's life underwriters may write non-investment term life business up to a maximum term of twenty five years. This permission is subject to the following conditions:

1 that managing agents advise their members underwriting life business whether the syndicate (or syndicates) in respect of which they participate, or propose to participate, intends to write business of any increased period above 10 years, whether or not up to the maximum term;

2 that no life syndicate shall write business that is or includes annuities without the permission of Lloyd's;

3 that no life syndicate shall write endowment policies without the permission of Lloyd's;

4 that no life syndicate shall write business that includes pensions or contracts to manage the assets of pension funds or such contracts when combined with contracts of insurance covering either conservation of capital or payment of minimum interest without the permission of Lloyd's;

5 that term life business will be subject to such byelaws, rules, regulations or other requirements as the Council may from time to time specify.

It is for the managing agents and life syndicates to decide the extent to which they avail themselves of the freedom to write non-investment term life business up to the maximum term of 25 years.

Viatical/After The Event Insurance

Viatical and After The Event Insurance are two classes of insurance that have been identified by Lloyd's as posing potentially a reputational risk to Lloyd's.

Therefore, no syndicate should write these classes of insurance without prior agreement by PMD. PMD will require full details of the managing agent's proposals for writing these classes before approval will be given. In particular, managing should be able to provide the following information:

- How the managing agent will manage the potential reputational risks to Lloyd's;
- The underwriting process used to write the business, including the methodology used to price the business;
- The methodology used to reserve for the business, including controls used to manage the long-tail effects of the business;
- The process used for the handling of claims; and,
- The operational controls in place to manage the business.
- An explanation of the products offered.
- Details of the experience of the underwriter and support staff.

Retrospective Reinsurance

The writing of retrospective reinsurance includes the writing of run-off covers, stop loss policies, adverse development covers, portfolio transfers and all similar arrangements. Such policies may be written in respect of whole books of business or to cover particular risks. Their common feature is that the reinsurance provides retrospective cover, covering business that has already been written by the reinsured and where losses may already be developing. The purpose of the reinsurance is to cap or take over entirely the liabilities of the reinsured in respect of the developing losses.

Although not reinsurance, Part VII Transfers are for these purposes considered to be equivalent to retrospective reinsurance.

The Lloyd's market is primarily a market for writing live risks and prudential concerns can arise where Lloyd's syndicates write retrospective reinsurance of company market risks. The writing of retrospective reinsurance can involve taking

on very large exposures in circumstances where it can be difficult to assess the underlying risks either due to poor records or other uncertainties. These issues can make it difficult for Lloyd's to assess whether syndicates have the necessary competencies to take on the business and whether the business is being appropriately priced and reserved.

Retrospective reinsurance also exposes the Central Fund to risks that were not written in the Lloyd's market.

Lloyd's does not believe that it will ordinarily be prudent to write retrospective reinsurance into the Lloyd's market. Given the concerns involved, Lloyd's considers that it is appropriate to require that any managing agent that wishes to provide retrospective reinsurance for non-Lloyd's business should first obtain the agreement of PMD for each retrospective reinsurance contract that it proposes to write.

This section does not apply to the writing of RITC, which is subject to separate requirements.

Patient Protection & Affordable Care Act

On 23 March 2010, President Obama signed the Patient Protection & Affordable Care Act ("PPACA"), which enacted a comprehensive reform of the private health insurance marketplace in all U.S states and the District of Columbia (the "Healthcare Reforms").

For insurers that may be deemed within its scope, PPACA imposes a number of significant obligations including the elimination of coverage limits and the requirement from 2014 of guaranteed renewability on all policies. Lloyd's wishes to ensure that all managing agents are familiar with the provisions of PPACA and have given proper consideration to any business that might fall within the scope of the legislation. Lloyd's expects that any proposal to write potential PPACA business (direct and reinsurance) should be stated expressly in the syndicate business plan. Managing agents must also demonstrate that their board has considered and is satisfied that the syndicate is able to comply with the regulatory requirements of PPACA and can manage the additional exposures that arise.

Underwriters who write Accident and Health and in particular Medical Expenses or other related classes should ensure therefore that they have addressed the following points:

1 Underwriters should ensure that they are familiar with the PPACA reforms and should avoid inadvertently providing coverage that may fall within its scope. Any proposal to write such business, both direct and reinsurance, must be included in the syndicate's business plan and will require the agreement of the PMD. Managing agents will need to demonstrate that the board has considered and is satisfied that the syndicate that intends to write coverage that may fall within the scope of PPACA is able to comply with the regulatory requirements of PPACA and can manage the additional exposures that arise from the US "Market Reforms".

2 Underwriters must ensure that they are taking a cautious approach when relying on exemptions from PPACA. Where there is any doubt they should consult with Lloyd's, including the Lloyd's International Trading Advice (LITA) team and, where appropriate, obtain suitable legal advice.

3 Where they have not already done so, underwriters should review all existing business to ensure that it does not fall within the scope of PPACA.

4 Where a policy is issued to a non-US employer but may cover US resident insureds, underwriters should consider the following options to reduce the risk of PPACA applying. Note that these suggestions are not a substitute for a proper assessment of the application of PPACA to the product in question:

- Place a disclaimer on any master policy issued that is likely to cover US resident insureds stating that the coverage does not provide the minimum essential benefits and other market reforms required by PPACA;
- Exclude the coverage of US resident insureds in any master policy issued outside the US that could provide such coverage under its terms; or
- Shorten the term of coverage for US resident insureds to less than the term of the shortest policy issued by the health insurance exchanges when they become operational (at present we believe this may be three months, but underwriters will need to monitor this issue as the health insurance exchanges are not yet operating) or shorten the term of the master policy to less than twelve months.

The regulatory landscape is continuing to evolve as PPACA is implemented. The interpretation of PPACA provisions in a number of respects remains unclear and many of the related regulations have yet to be issued. Underwriters will therefore need to monitor developments.

For more information managing agents should visit Crystal which includes a copy of the letter sent by David Indge to all

Active Underwriters/Directors of Underwriting and Compliance Officers on 26 September 2011 together with the accompanying Memorandum produced by the US law firm, SNR Denton.

POLITICAL RISK & CREDIT CLAIMS STATEMENT OF BEST PRACTICE

APPENDIX 1

Applicable to PR, CF and CR risk codes

The Lloyd's leader must ensure that other Lloyd's agreement parties are advised, including XCS in order that they may advise the following market

—	SITUATION	ACTION (CF, CR RISK CODES)	ACTION (PR RISK CODE INCLUDING CEND & AIRCRAFT REPO)
1	**The insured notifies of a possible claim or circumstance that may give rise to a claim**	• Monitor • Advise other Lloyd's agreement parties including XCS • In the event of insolvency advice is to be immediate	• Monitor • Advise other Lloyd's agreement parties including XCS • In the event of CEND advice is to be immediate
2	**Waiting Period is triggered**	• Monitor • Advise other Lloyd's agreement parties including XCS • Where Waiting Period is less than 180 days, advice is to be immediate	• Monitor • Advise other Lloyd's agreement parties including XCS • Where Waiting Period is less than 180 days, advice is to be immediate
	Waiting Period is less than 180 days, or 180 days or more but 50% eroded	• Claim agreement parties (CAP) to determine coverage and communicate reserving and recovery strategy to followers • Include Loss Adjuster, Legal Team, Recovery Agent as applicable	• Claim agreement parties (CAP) to determine coverage and communicate reserving and recovery strategy to followers • Include Loss Adjuster, Legal Team, Recovery Agent as applicable
3	**Recovery prospects**	• Determine recovery strategy at the time of reserving if possible and communicate to CAP	• Determine recovery strategy when reserving & communicate to CAP
4	**Waiting Period expired and claim validated**	• Pay & initiate recovery procedure • Provide regular updates to the following market through XCS unless and until recoveries are exhausted	• Pay & initiate recovery procedure • Provide regular updates to the following market through XCS unless and until recoveries are exhausted