

# MARKET BULLETIN

REF: Y4977

<b>Title</b>	Letter Of Credit Facility for Lloyd's Syndicates writing off-shore Chinese reinsurance
<b>Purpose</b>	To inform the market of changes to the existing Letter of Credit Scheme operated by Lloyd's and Citibank to include Chinese reinsurance business
<b>Type</b>	Event
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<b>Date</b>	4 March 2016
<b>Deadline</b>	Immediate
<b>Related links</b>	<a href="#">Lloyd's Market Bulletin Y3097</a>

## **Background**

This bulletin is addressed to all Lloyd's market stakeholders dealing with the placement and underwriting of reinsurance business from China. Under China's second generation solvency system ("C-ROSS"), effective from 1 January 2016, Chinese cedants will incur a capital charge of 58.8% on unsecured reinsurance balances due from overseas reinsurers. Secured reinsurance balances attract a lower charge of 8.7%.

It is therefore possible that Lloyd's syndicates writing offshore Chinese reinsurance business (principally from London, Singapore and Hong Kong) may be required to provide collateral to secure balances if required to do so by the Chinese cedant or asked to include a suitable form of collateralisation clause to permit collateral to be provided during the period of the contract. Lloyd's is aware that some contracts have already seen C-ROSS collateral clauses included, which permit collateral to be called by the cedant (see Appendix A).

Separate arrangements will apply to Lloyd's syndicates writing Chinese reinsurance business through Lloyd's China. Chinese reinsurance business assumed by Lloyd's China, as a domestic reinsurer, is subject to a lower capital charge of 0.50% provided that its solvency ratio is at least 200%.

Any questions concerning C-ROSS requirements should be addressed, in the first instance to Lloyd's International Trading Advice (see "Further information and Contacts" below).

### **Collateral requirements**

In accordance with requirements issued by the China Insurance Regulatory Commission (“CIRC”) (Article 29 of the Regulatory Rules governing Solvency of Insurance Companies No. 8: Minimum Credit Risk Capital), the collateral recognised under the Rules to allow lower counterparty credit risk factors to apply include:

- “i. Deposit funds deposited by reinsurer with the cedant for the purpose of guaranteeing the cedant’s recovered reinsurance amount;*
- ii. The letter of credit issued by a non-related-party financial institution with the credit rating no lower than AA- or a non-related-party domestic bank with the capital adequacy ratio of no less than 11%, for the purpose of guaranteeing the cedant’s recovered reinsurance amount;*
- iii. Other guarantee measures recognized by the CIRC.”*

This means collateral does not need to be in the form of a letter of credit (LOC). The same could be achieved by the Chinese cedant retaining a Loss and/or Premium Reserve Deposit. CIRC have not to-date issued any regulations or further guidance relating to the form of LOC’s or other guarantee measures although we understand that they have plans to do so in 2016 and will consider international practice. Given the uncertainty around the lack of guidance (subject to any detailed requirements from CIRC or cedants), Lloyd’s intends to allow the market to use the existing central LOC facility which Lloyd’s brokers and syndicates are familiar with.

### **Lloyd’s central LOC facility**

The Lloyd’s central LOC facility requires policy details to be recorded by Xchanging. If original policy details are not recorded by Xchanging (for example some business written through Singapore or Hong Kong) then documentation must be provided to enable a record to be created. Alternatively, the syndicate would need to provide funds outside of Central Accounting to Citibank UK or select another bank to issue the LOC. Please contact Lloyd’s Settlement and Trust Fund Office (STFO) to discuss these options further. Please note that the Lloyd’s Dollar Trust Fund (LDTF) cannot be used to collateralise Chinese Reinsurance where this business has not been processed through the LDTF.

For details of Lloyd’s central LOC facility and how syndicates can participate in the facility, please refer to Lloyd’s Market Bulletin Y3097 (see “Related links” above). For a syndicate to participate in this facility they must first have completed the relevant legal documentation between themselves and Citibank (with whom Lloyd’s operates the LOC facility). Most syndicates will already be able to participate and Citibank have confirmed that no further documentation is required to issue an LOC in China. Under the facility one LOC would be issued on behalf of all syndicates on the same risk (i.e. guided by the lead syndicate, all syndicates participating on the risk must utilise the same form of collateral). **If a syndicate**

**does not already participate in the facility then issuance would be delayed until documentation is in place.**

We therefore would encourage all syndicates writing offshore Chinese reinsurance to ensure that they have completed the necessary registration document with Citibank to ensure that the process of lodging collateral when required can be made more efficient.

Citibank have been considering the C-ROSS requirements and have confirmed that:

- A local bank is required to issue the LOC so that the guarantee is covered by PRC law and eliminates the need for a cedant to seek approval for a cross border transaction. Citibank China meets the regulatory requirements for issuing an LOC (rating and capital adequacy) and has prepared a form of an LOC which has already been successfully issued to local cedants.
- The currency of the LOC should be the same as the settlement currency in the reinsurance contract.
- Citibank's template with suggested edits to make it relevant for Lloyd's syndicates is attached at Appendix B. Collateral held would normally be held by the instructing bank outside China in the same currency.
- Citibank's charges would be 0.25% per annum with a set-up fee of \$1,000 per LOC. Interest is paid on collateral deposits.

### **Further Information and Contacts**

For enquiries concerning C-ROSS requirements:

Lloyd's International Trading Advice  
Lloyd's Desk, Ground Floor, Underwriting Room  
t: +44 (0)20 7327 6677  
e: [LITA@Lloyds.com](mailto:LITA@Lloyds.com)  
[www.lloyds.com/crystal](http://www.lloyds.com/crystal)

or for questions concerning the issuing of LOCs:

Donna Broughton  
Settlement & Trust Fund Operations  
t: +44 (0)1634 392693  
e: [donna.broughton@lloyds.com](mailto:donna.broughton@lloyds.com)

## **Appendix A**

### **Example of collateralisation clause**

Lloyd's understands that the following security clause has been widely used and included in 2016 treaties:

“In accordance with the conditions of the China Risk Oriented Solvency System (C-ROSS) which will be formally implemented by the China Insurance Regulatory Commission (CIRC) during the period of this Reinsurance Contract, it is hereby noted and agreed that, the Reinsured will be entitled to retain a Loss Reserve deposit or, alternatively at the Reinsured's option, the Reinsurer will provide a Letter of Credit or any other form of funding as allowed by the CIRC regulations, as collateral against any credit risk arising from any losses falling within the scope of this Contract, subject to such loss being notified by the Reinsured and validated by the Reinsurer.

This Clause shall only apply to overseas reinsurers and shall be subject to the conditions as may be required by the C-ROSS regulations which come into force.”

The collateralisation clause does not apply to Lloyd's China which is an onshore reinsurer.

**Appendix B**

**Citibank LOC template**

**Citibank Payment Guarantee Template**

Our Reference No: [REDACTED]

Issuance Date: [REDACTED]

To: [REDACTED] Ltd.

Address: [REDACTED]

This Payment Guarantee is hereby issued in relation to the Reinsurance Contract No. [REDACTED] dated [REDACTED], 20[REDACTED] (hereinafter called the "Contract") signed between [REDACTED] (hereinafter called "the Syndicates" and each a "Syndicate") and [REDACTED] (hereinafter called the "Insurance Company") for the reinsurance service provided by the Syndicates.

At the request of the Syndicates, we, Citibank (China) Co., Ltd. Shanghai Branch, hereby issue this Payment Guarantee ("Guarantee") and undertake to pay you up to the aggregate amount of [REDACTED] (CNY Yuan or USD Dollars) (hereinafter called the "Maximum Guarantee Amount"), within three (3) banking days upon receipt of your first written demand, which shall bear our Guarantee number and state that the Syndicates have failed to effect payment under the Contract.

This Guarantee sets forth the full terms of our undertaking and such undertaking shall not in any way be modified, amended or amplified by reference to any document or instrument referred to herein or to which this Guarantee relates and shall not be deemed to incorporate by reference any such document or instrument.

This Guarantee shall come into effect upon the issuance date of this Guarantee and remain valid till [REDACTED], 20[REDACTED] or the expiration date of the renewal, if any (hereinafter called the "Expiry Date").

This Guarantee will be deemed to be automatically extended without amendment for twelve (12) months from the relevant Expiry Date, unless at least thirty (30) days prior to the relevant Expiry Date, we notify the Insurance Company by registered mail that this Guarantee will not be renewed anymore.

All the written claims hereunder, if any, shall be received by our Bank before 4pm Beijing time of the Expiry Date. Within three (3) working days after receipt by us of the Insurance Company's written notice on their headed stationery signed on their behalf by an authorised signatory/signatories stating that the Syndicates have failed to faithfully perform their obligations as stipulated in the Contract, such written notice to provide details of the failure of performance by the Syndicates including the amount of the Syndicates' liability not paid, we shall immediately and unconditionally pay to the Insurance Company the amount of

such Syndicates' liability (the aggregate of all Syndicate liabilities to be paid under this Guarantee not to exceed [REDACTED] (CNY Yuan or USD Dollars).

This Guarantee should be returned to Citibank (China) Co. Limited Shanghai Branch, Trade Department, Room 217, 2<sup>nd</sup> Floor, Building 1, 1000 Chenhui Road, Shanghai 2101203 on the earlier of (1) the date when the Maximum Guarantee Amount hereunder has been fully claimed, and (2) the next day of the Expiry Date. After the Expiry Date, this Guarantee shall be null and void irrespective of whether or not it is returned to our Bank.

This Guarantee shall not be transferred or assigned without our Bank's prior written consent.

This Guarantee is payable solely at and by Citibank (China) Co., Ltd. Shanghai Branch.

This Guarantee is subject to the International Standby Practices 1998, ICC Publication No. 590 ("ISP98"), and as to matters not addressed by ISP98, shall be governed by the laws of People's Republic of China.

Citibank (China) Co., Ltd. Shanghai Branch