

Market Bulletin

Ref: Y5236

Title	Syndicate loans to the Central Fund
Purpose	To advise the market of the terms and other matters related to syndicate loans to the Central Fund, with effect from the 2019 year of account.
Type	Event
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Deadline	
Related links	-

Lloyd's will introduce syndicate loans to the Central Fund with effect from the 2019 year of account and plan to continue doing so in subsequent years, subject to the Council's and the PRA's approval each year. Syndicate loans will be collected in respect of all members' active syndicate participations for the respective year of account. The loan will involve the transfer of Tier 1 capital (cash) from the Premiums Trust Funds of the relevant syndicate members to the Central Fund.

The proceeds from the syndicate loans will be used to strengthen Lloyd's central resources and facilitate the injection of capital to Lloyd's Insurance Company SA ('Lloyd's Brussels'). This should eliminate the need to raise additional member capital to support the ongoing underwriting of Lloyd's Brussels. Lloyd's will consider in due course how capital will be raised to support the Part VII transfer of Members' EEA business to Lloyd's Brussels.

The terms and other matters included in this market bulletin supersede those included in market bulletin Y5210.

Terms of the syndicate loans

The terms of the syndicate loans are designed to enable them to be treated as restricted Tier 1 capital for Lloyd's central solvency under the Solvency II regime. The full syndicate loan terms are set out in the loan requirements included in Appendix 1 and a summary of the key terms is set out below.

Effective date: loans will commence on 31 March of the year of account unless that date falls on a weekend, in which case the commencement date will be the last working day before 31 March. The loans for the 2019 year of account will commence on 29 March 2019.

Loan value: The quantum of syndicate loans will be determined as a percentage of the premium income limit for all members' active syndicate participations for the respective year of account. For this purpose, the premium income limit is defined as gross written premium from the latest approved syndicate business plans. The percentage of gross written premium will be determined annually, be subject to Council's approval and will be communicated to market participants prior to the commencement of the respective year of account. Syndicate loans for the 2019 year of account will be 0.33% of each syndicate's gross written premium.

Tenure: loans for any year of account will not be repaid before 5 years has elapsed. Members should note that they should not have any expectation that the loans will be repaid after 5 years.

Interest: the interest rate will be determined by reference to a risk-free yield plus a credit spread. The interest rate will be communicated at the commencement of the loan and a separate interest rate will be set for each year of account. The interest rate for the 2019 year of account will be based on the risk-free rate relative to 5-year UK gilt yields plus a 3% credit spread. Interest will normally be paid annually on an anniversary of the loan however the Council may elect in its absolute discretion to cancel payment of all or any interest which the Society is required to pay on any interest payment date.

Subordination: in the event of a winding up of the Society, its obligations to members under the loans will be subordinated to all other obligations of the Society except those which are expressed to rank equally with or in subordination to the syndicate loans. This applies in particular to the payment of any underwriting liabilities of the members of syndicates for which the New Central Fund or other assets of the Society may at any time, in the discretion of the Council, be applied under the New Central Fund Byelaw (No 23 of 1996).

Currency: syndicate loans will be denominated in Sterling.

Impact on member capital and solvency

Syndicate loans are reported as assets on a syndicate's solvency return and are available to meet a member's solvency and capital test requirements. The issuance of syndicate loans will have no impact on a member's solvency or capital position i.e. everything else

being equal, a member's solvency and capital position is no different before or after the issuance of syndicate loans.

Guidance on reporting syndicate loans in the QMA and QSR is included in the instructions for the respective returns.

Impact on Re-Insurance to Close ('RITC')

Where a year of account closes naturally, normally after three calendar years, the members of the closing year of account will assign their rights attached to the syndicate loan to the members of the accepting year of account, enabling full distribution of the result for the closing year of account. The accepting year of account will reflect the syndicate loan as an asset.

Administrative arrangements

Syndicate loans will be collected via ARCS, the same mechanism used to collect Lloyd's market charges. Syndicates will be provided with a collection advice before the syndicate loan has been collected, evidencing the amount of their member(s) loan to the Central Fund and the rate of interest. Remittance advices will also be provided to syndicates to support the payment of interest.

Lloyd's will advise members and managing agents of its solvency position in February and August each year, in advance of the submission deadlines for the annual and half year QMAs. The solvency position reported will be based on unaudited syndicate solvency returns and central assets.

Please contact Tim Culshaw (Tim.culshaw@lloyds.com) if you have any queries on solvency and accounting aspects. For queries regarding the administrative arrangements, please contact Carolyn Smith (Carolyn.smith@lloyds.com).

Steve Jules

Appendix 1**NEW CENTRAL FUND SYNDICATE LOAN REQUIREMENTS**

The Council of Lloyd's, in exercise of its powers under paragraph 40 of the Membership Byelaw (No. 17 of 1993) and paragraphs 6 and 8 of the New Central Fund Byelaw (No. 23 of 1996) and all other powers enabling, hereby prescribes the following conditions and requirements and resolves as follows:

1. Interpretation and citation

- (1) The provisions of the Schedule hereto (interpretation) shall have effect.
- (2) These conditions and requirements may be cited as the New Central Fund Syndicate Loan Requirements.
- (3) Any references to EU legislation shall be understood as references to the equivalent UK legislation once the United Kingdom has left the European Union.

2. Requirement to make New Central Fund Syndicate Loans

- (1) It shall be a condition of a member's permission to underwrite insurance business for the 2019 year of account or any subsequent year of account that, for each syndicate of which he is a member for that year of account, an amount equal to 0.33% (or such other rate as the Council may prescribe) of his member's syndicate premium limit for that syndicate be lent to the Society in accordance with and on the terms specified in these conditions and requirements (an "NCF syndicate loan").

- (2) An NCF syndicate loan shall be made at the direction of the managing agent of the syndicate concerned out of the Managing Agent's Sub-Fund of the member.
- (3) Any NCF syndicate loan shall be made in full on 31 March (or such other date as the Council may specify) of the year of account for which it is required to be made.
- (4) Every NCF syndicate loan required by these conditions and requirements shall be made without set-off, counterclaim, or deduction on any account whatsoever.
- (5) The Council may from time to time specify arrangements for the making of NCF syndicate loans, including the establishment of direct debit arrangements to be entered into between managing agents, or Managing Agent's Trustees, and the Society.

3. Currency of account

- (1) The currency of account of an NCF syndicate loan shall be sterling.
- (2) Accordingly, any NCF syndicate loan shall be made, any repayment thereof shall be made, and any interest payable thereon shall be paid, in sterling.

4. Management of New Central Fund

The proceeds of all NCF syndicate loans shall be held, managed, invested and applied as assets of the New Central Fund.

5. Interest

- (1) Interest shall be paid by the Society on any NCF syndicate loan at such rate or rates and on such dates (each an “interest payment date”) as the Council shall specify. The interest rate payable shall incorporate a risk-free yield element plus a credit spread element reflective of the investment risk taken by the market by participating in the syndicate loan. The Council may elect in its absolute discretion to cancel payment of all or any interest which the Society is required to pay on any interest payment date. Any failure to pay interest shall not constitute a default by the Society for any purposes. Where an interest payment is cancelled, that interest does not become due and was never due.
- (2) Interest shall be paid after any deduction or withholding which the Society is required to make by any applicable law. Where the Society has paid an amount of interest on any NCF syndicate loan without deduction or withholding and it is subsequently determined by any tax authority that deduction or withholding was required in respect of that payment, the member who received the interest shall pay to the Society, within 30 days of receipt of demand, the amounts that should have been deducted or withheld by the Society.
- (3) All interest shall be paid out of the New Central Fund.

6. Repayment of NCF syndicate loans

- (1) The Society shall be under no obligation to repay any NCF syndicate loan at any time otherwise than in the winding-up of the Society when it shall be obliged to repay any NCF syndicate loan, subject to sub-paragraph 6(8) and paragraph 7 below.

- (2) The Society may, in the discretion of the Council, only once a period of at least five years has elapsed after the date of collection of the NCF syndicate loan for any year of account, or at any later point in time (provided that where a period of between 5 and 10 years has elapsed after the date of collection of the NCF syndicate loan the Society's Market Wide Solvency Capital Requirement and Central Solvency Capital Requirement are exceeded by an appropriate margin taking into account the solvency position of the Society including the Society's medium-term capital management plan), repay the whole or any part of any NCF syndicate loan in respect of that year of account at such time or times as the Council thinks fit.
- (3) Repayments shall be made out of the New Central Fund.
- (4) Subject to sub-paragraph 6(6), the Society shall not repay any NCF syndicate loan in respect of a particular member or in relation to any particular syndicate for a particular year of account without assuming an obligation that all other NCF syndicate loans in respect of that year of account will be repaid at the same time.
- (5) The Society shall not repay any NCF syndicate loan unless it has received the prior approval of the Prudential Regulation Authority.
- (6) In the event of the winding-up of the Society -
 - (a) the obligations of the Society in respect of all NCF syndicate loans outstanding rank equally among themselves; and
 - (b) the obligations of the Society in respect of NCF syndicate loans outstanding are subordinated to –
 - (i) all other obligations of the Society except those which are expressed to rank equally with or in subordination to NCF syndicate loans; and

(ii) the payment of any underwriting liabilities, other than excluded liabilities, of members (or former members of Lloyd's or the estates of deceased members of Lloyd's) for which the New Central Fund or other assets of the Society may at any time, in the discretion of the Council (whether that discretion is exercised before or after the commencement of the winding-up of the Society), be applied under the New Central Fund Byelaw (No. 23 of 1996);

but rank in priority to the distribution of any remaining assets of the Society to members of the Society (for the avoidance of doubt, this shall include only distributions of assets to members of the Society in their capacity as members of the Society and not payments made to members of the Society in their capacity as creditors of the Society).

(7) In sub-paragraph 6(6) –

(a) "excluded liability" means any liability of a member in respect of which Equitas Reinsurance Limited has, under a reinsurance and run-off contract made by it with that member, undertaken to reinsure and indemnify that member, other than any such liability which the Society has a legally binding obligation to pay or discharge on behalf of the member, or to indemnify the member against, under any contract entered into with, or other instrument executed in favour of, the member at or before the time when the New Central Fund Byelaw (No 23 of 1996) came into force (and for the purpose of this sub-paragraph references to a member shall include references to a former member or the estate of a deceased member); and

- (b) nothing shall fetter or otherwise affect the Council's discretion at any time to decide whether or not to apply the New Central Fund or other assets of the Society in the payment of underwriting liabilities.
- (8) The claims of members in respect of NCF syndicate loans shall, in a winding-up of the Society, be contingent upon the Society having, and shall only be due and payable in the event that the Society has, assets remaining after payment of and/or provision for the claims of all senior creditors in full.

7. Solvency Condition

- (1) The Society shall have no liability (whether actual, contingent or prospective) to repay any NCF syndicate loan or to pay any interest on an NCF syndicate loan, including any repayment or payment of interest previously promised by the Society, where there is non-compliance with the Society's Market Wide Solvency Capital Requirement or Central Solvency Capital Requirement or redemption or payment of interest would lead to such non-compliance, unless:
 - (a) in the case of repayment, all of the following conditions are met:
 - (i) the Prudential Regulatory Authority has exceptionally waived the suspension of repayment of the NCF syndicate loan;
 - (ii) the NCF syndicate loan is exchanged for or converted into another Tier 1 own-fund item of at least the same quality; and
 - (iii) the Minimum Capital Requirement is complied with after repayment; or
 - (b) in the case of payment of interest, all of the following conditions are met:

- (i) the Prudential Regulatory Authority has exceptionally waived the cancellation of distributions;
 - (ii) the distribution does not further weaken the solvency position of the Society; and
 - (iii) the Minimum Capital Requirement is complied with after the distribution is made.
- (2) In the event of the occurrence of significant non-compliance with the Market Wide Solvency Capital Requirement or Central Solvency Capital Requirement as defined in paragraph 7(3) below, the NCF syndicate loans shall be written down to nil on a permanent basis without delay, including any claim of a lender in the event of winding-up proceedings and the amounts required to be paid on repayment and on any interest payments.
- (3) Non-compliance with the Market Wide Solvency Capital Requirement or Central Solvency Capital Requirement shall be significant where:
- (a) the amount of own-fund items eligible to cover the Market Wide Solvency Capital Requirement or Central Solvency Capital Requirement is equal to or less than the 75% of the Market Wide Solvency Capital Requirement or Central Solvency Capital Requirement respectively;
 - (b) the amount of own-fund items eligible to cover the Minimum Capital Requirement is equal to or less than the Minimum Capital Requirement; or
 - (c) compliance with the Market Wide Solvency Capital Requirement or Central Solvency Capital Requirement is not re-established within a period of three months of the date when non-compliance with the Market Wide Solvency Capital

Requirement or Central Solvency Capital Requirement was first observed.

8. Remedies

Lenders' remedies in respect of non-payment of any sum owed by the Society under an NCF syndicate loan or in respect of any other breach of the terms of the New Central Fund Syndicate Loan Requirements shall be limited to proving for any amount owed by the Society and claiming such sum in the liquidation of the Society.

9. Set-off

Lenders shall, to the fullest extent possible under applicable law, waive their rights to set off against amounts they owe to the Society in respect of the NCF syndicate loans any amounts owed by the Society to them. To the extent that, notwithstanding the foregoing sentence, any set-off takes place, whether by operation of law or otherwise, between: (a) any amount owed by the Society to the lender in respect of a NCF syndicate loan, and (b) any amount owed to the Society by such lender, the lender shall immediately transfer an amount equal to the amount which is set off to the Society or, if applicable, the liquidator (or other relevant insolvency official) of the Society to be held on trust for the benefit of the senior creditors and, until such time as payment is made, the lender will hold a sum equal to such amount in trust for the Society or, if applicable, the liquidator (or other relevant insolvency official) of the Society.

10. Assignment

The entitlements of the lenders in respect of an NCF syndicate loan shall not be capable of assignment otherwise than –

- (a) in connection with a contract of reinsurance to close, to a reinsurer under that contract or to the Managing Agent's Trustees of that reinsurer; or
- (b) in connection with an insurance business transfer scheme, to a transferee, or to the Managing Agent's Trustees of the transferee under that scheme.

11. Governing Law and Jurisdiction

The terms of the NCF syndicate loans and any non-contractual obligations arising out of or in relation to the NCF syndicate loans shall be governed by and construed in accordance with the laws of England and Wales. The English courts shall have, and the parties to the NCF syndicate loans submit to the, exclusive jurisdiction in relation to all disputes arising out of or in connection with the NCF syndicate loans.

12. Commencement

These conditions and requirements shall come into force on 1 January 2019.

13. Purpose of NCF syndicate loans

- (1) The NCF syndicate loans are intended to qualify as Tier 1 basic own-funds under Directive 2009/138/EC (as amended by Directive 2014/51/EU) ("Solvency II") as implemented by Delegated Regulation 2015/35 and the European Insurance and Occupational Pensions Authority Level 3 Guidelines on classification of own funds.
- (2) The Prudential Regulation Authority shall be notified prior to any proposed amendment to the NCF syndicate loans.

SCHEDULE

Interpretation

1. Except where otherwise expressly provided in these conditions or requirements, or where the context otherwise requires, words and expressions used in these conditions and requirements which are defined in the Definitions Byelaw (No. 3 of 2004) have the meanings there given.

2. In these conditions and requirements –
 - “Central Solvency Capital Requirement” has the meaning of the amount of capital required to cover all the risks facing the Society and the Central Fund only, at a 99.5% confidence level over a one year time horizon as provided for in Solvency II legislation, save that “Solvency Capital Requirement” shall be read as reference to the Minimum Capital Requirement (as such term is provided for in Solvency II legislation) where non-compliance with the Minimum Capital Requirement occurs before non-compliance with the Solvency Capital Requirement.
 - “excluded liabilities” has the meaning given in paragraph 6(7);
 - “interest payment date” has the meaning given in paragraph 5(1);
 - “Managing Agent’s Sub-Fund” and “Managing Agent’s Trustees” in relation to a member and the managing agent of a particular syndicate, have the meaning given in the member’s premiums trust deed;
 - “Market Wide Solvency Capital Requirement” has the meaning of the amount of capital calculated to cover all of the risks of ‘the association of underwriters known as Lloyd’s’, i.e. those arising on syndicate activity, members’ capital provided

at Lloyd's and the Society taken together, at a 99.5% confidence level over a one year time horizon as provided for in Solvency II legislation, save that "Solvency Capital Requirement" shall be read as reference to the Minimum Capital Requirement (as such term is provided for in Solvency II legislation) where non-compliance with the Minimum Capital Requirement occurs before non-compliance with the Solvency Capital Requirement;

"NCF syndicate loan" has the meaning given in paragraph 2(1);

"Prudential Regulation Authority" means the UK Prudential Regulation Authority and any successor entity;

"senior creditors" means –

- (i) creditors of the Society; and
- (ii) creditors of members of the Society (or of former members or of the

estates of deceased members)

in respect of the obligations and underwriting liabilities to payment of which priority is given by paragraph 6(6)(b)(i) and (ii) respectively, but only as regards those obligations or underwriting liabilities.