Split Reinsurance to Close

Guidance for managing agents on Lloyd's approach

March 2023

1 Introduction

Where syndicate years of account are ready to close, ordinarily at 36 months, Lloyd's expects that the managing agent of the closing syndicate will effect the reinsurance to close (RITC) with another single syndicate year of account. This will usually be a later year of account of the same syndicate (typically, the following year of account, often referred to as the 'natural successor year') or it may be effected into a year of account of another syndicate (so-called 'third party RITC').

In the 'Performance Management – Supplemental Requirements & Guidance'[1] Lloyd's has made clear that no RITC contract may be written by two or more syndicates ('split RITC') other than with Lloyd's consent (or where parallel syndicates are the reinsuring syndicates).

In providing consent to split RITC Lloyd's recognises that there may be good reason why a managing agent wishes to split the closure of a syndicate year of account between two different syndicates. Reasons why syndicates may wish to enter into split RITC arrangements include because a syndicate may have exited a class of business and believes the run-off of the business would be better serviced by a third party syndicate, or to provide finality on books in run-off or for capital efficiency reasons.

Lloyd's will consider any such application and co-ordinate with the PRA in accordance with the guidance and procedure set out in this document[2].

In view of the definition of 'approved reinsurance to close' in the PRA Rulebook, RITC contracts to be written by more than one syndicate will additionally require an application to the PRA for a rule modification[3]. Lloyd's and the PRA will independently consider any application for 'split RITC' (and any decision by Lloyd's to endorse an application does not imply agreement will also be given by the PRA.

2 Relevant Rules

The following is a brief summary of the relevant requirements that govern reinsurance to close at Lloyd's.

2.1 Lloyd's Requirements

The definition of reinsurance to close at Lloyd's is set out in the Definitions Byelaw. For present purposes, this includes[4]:

1. Where the reinsurance to close is between two years of account of the same or different syndicates that have different members or there is more than one member on either syndicate year of account:

   A reinsurance where the reinsuring members of a single syndicate agree to discharge or procure the discharge of, or indemnify the reinsured members against, all known and unknown liabilities of the reinsured members arising out of insurance business underwritten through that syndicate and allocated to the closed year of account. In consideration, the reinsuring members will receive a premium and the benefit of all the rights of the reinsured members arising out of or in connection with that insurance business (primarily, future premium, reinsurance recoveries and other rights of recovery).

2. Syndicates consisting only of a single corporate member which is not closed to another syndicate:

   RITC in such a case is achieved by the inclusion in the underwriting account of that syndicate for the next following year of account of an amount representing a provision for all known and unknown liabilities attributable to the year of account which is closing. As the member on both years of account is the same and there is only one member involved, a contract of reinsurance to close is not required in this case.

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[1] www.lloyds.com/supplementalrequirements
[2] For these purposes, split RITC includes where part of a year account is reinsured to the third party syndicate and part is closed to the following year of account of the same syndicate.
[3] The relevant rule requiring modification is SII Firms –Lloyd's – Lloyd's Approved Reinsurance to Close – Rule 3.1
[4] See the definition of 'reinsurance to close' in the Definitions Byelaw. The definition additionally makes provision for reinsurance to close to a Lloyd's subsidiary, although presently this is not available as an option.

3 Other cases:

An agreement will qualify as reinsurance to close if it is underwritten by members of one or more syndicates and complies with any requirements made under paragraph 1(2) of the Syndicate Accounting Byelaw. Paragraph 1(2) allows Lloyd's to prescribe requirements for the content or form of any contract of reinsurance.

The definition of reinsurance to close under (3), therefore, can include a reinsurance to more than one syndicate (ie split RITC) provided there is compliance with paragraph 1(2) of the Syndicate Accounting Byelaw.

Lloyd's has set out various requirements for reinsurances to close, which can be found in the 'Performance Management: Supplemental Requirements & Guidance'[5]. These additional requirements emphasise that any split RITC must be agreed by Lloyd's.

There are additional accounting requirements that apply to RITC set out in the Syndicate Accounting Byelaw.

2.2 PRA Rulebook

The PRA Rulebook at 'SII Firms – Lloyd's – Lloyd's Approved Reinsurance to Close – Rule 3.1'[6] provides that where a reinsurance to close qualifies as an 'approved reinsurance to close' then for the purposes of the PRA's rules (including for the purposes of determining the capital requirements of members) all contracts of insurance reinsured under the approved reinsurance to close must be treated as if the reinsuring member and not the reinsured member had effected the original contract of insurance. Syndicates that have reinsured to close are therefore not required by the PRA to hold capital against their inwards liabilities and can be treated as 'closed'[7].

The PRA definition of Approved Reinsurance to Close parallels Lloyd's definition but only applies to arrangements between a single syndicate reinsuring to another single syndicate (including a subsequent year of account of the same syndicate). The PRA Rulebook definition of Approved Reinsurance to Close does not allow for reinsurance to two or more syndicates. Any split RITC arrangement therefore requires a rule modification to qualify as an Approved Reinsurance to Close. The statutory criteria that the PRA will apply in considering an application for a rule modification are set out in the Financial Services and Markets Act 2000, s.138(A)(4)[8].

3 Lloyd's approach to endorsing a split RITC proposal

Lloyd's recognises that split RITC can be a good option for syndicates that wish to achieve finality in respect of business in run-off. Lloyd's will therefore consider each proposal on its individual merits to determine whether or not to endorse an application by the managing agent of the ceding syndicate for a PRA rule modification. Lloyd's expects managing agents to have considered the points set out below prior to making any formal application. At a minimum, managing agents must provide relevant information and appropriate supporting documents that address these points in any written application proposal.

Note: at this time, DXC cannot take claims payments from two different PTFs, for two different classes of business underwritten on the same pure year of account. Therefore, Lloyd's is presently not able to agree to split RITC arrangements where that would involve splitting the RITC of a single year of account, where that would involve separating business that has claims processed and paid through DXC.

3.1 Rationale for split RITC

1 Managing agents must be able to provide Lloyd's with a robust rationale for any split RITC proposal. The rationale should outline the financial and operational benefits to the closing syndicate and any benefits for policyholders. Managing agents, should explain what other options they have considered and why they consider split RITC to be the most appropriate solution.

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[5] See www.lloyds.com/supplementalrequirements
[6] See https://www.prarulebook.co.uk/rulebook/Content/Chapter/213167/20-08-2021
[7] See Rule 3.1 for further details.
[8] S.138(A)(4) states: "(4) The Authority may not give a direction unless it is satisfied that:
(a) compliance by the authorised person with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made; and
(b) the direction would not adversely affect the advancement of any of the regulator's objectives."

2 If the business being reinsured to close to a third party reinsurer includes business that the reinsured syndicate continues to underwrite as an ongoing portfolio, this should explained and quantified with an explanation as to why it is preferable to pass management of claims under these policies to another managing agent. Any impact on policyholders that this may have should be addressed, particularly where policyholders are identified as consumer policyholders.

3 Having regard to the PRA's criteria for permitting a rule modification, in providing any rationale, the managing agent should also explain why not allowing the split RITC would be unduly burdensome and how the managing agent is satisfied that the split RITC will not result in an undue regulatory risk, particularly in relation to the risk to policyholders.

3.2 Operation of RITC

It is of critical importance that the managing agent can demonstrate that any split RITC will operate effectively, notwithstanding the reinsurance to close being divided between different syndicates. This means that in addition to meeting the requirements for reinsurance to close as set out in the Supplemental Requirements managing agents should be able to demonstrate the following:

a. The reinsurance to close is clear in the reinsurance wording as to how policies will be allocated between the reinsuring syndicates in a way that ensures there is no possibility of risks 'falling between the cracks' and not being covered by either reinsurance to close contract. In the event that disagreement does arise as to which syndicate is the relevant RITC reinsurer then any delay in resolution must not be to the detriment of the policyholder and the parties must be able to explain how any valid claim will be settled, if necessary prior to resolution between the reinsuring syndicates. Lloyd's will require copies of any proposed reinsurance to close wordings for review to ensure this is adequately addressed.

b. There is a clear apportionment of any outwards reinsurance between the two parts of the split RITC. Preferably there should be no shared reinsurance. If there is any shared reinsurance, there needs to be a clear arrangement for the apportionment of that. The applicant managing agent must be able to show how the reinsuring syndicates will not be at risk of losing their reinsurance recoveries by reason of one syndicate doing something that may void or invalidate the reinsurance or erode the limits in a way that prejudices the other syndicate.

c. There are clear arrangements for the administration and handling of claims and complaints. With regard to claims notifications and associated messages, the managing agent must be able to confirm that these will be directed to the appropriate party after the split is effected. Each reinsuring syndicate should also demonstrate that claims payments for their portion of the reinsured business is drawn from the appropriate PTF or account. Preferably the claims handling arrangements for each reinsuring syndicate should be independent of the claims handling arrangement of the other syndicate.

d. Each reinsuring syndicate will have all necessary management information and data, including for the purposes of providing all necessary Lloyd's and other regulator returns. The managing agent of each reinsuring syndicate should not be reliant on the managing agent of the other syndicate for the provision of information following the completion of the RITC. The corollary of this is that the closing syndicate should be able to show that it has planned for and is able to transfer any data and management information required by the reinsuring syndicates and will continue to support the reinsuring syndicates with any queries that may arise regarding the data, to the extent reasonably required.

e. The managing agent of each reinsuring syndicate is able to demonstrate that it has the expertise and resources to adequately manage the transferred business. Lloyd's is unlikely to approve a split RITC which requires significant manual or system intervention to facilitate the processing of the business by one of the managing agent agents of a reinsuring syndicate. To the extent that any are required, Lloyd's will require full details of any manual or system interventions that must be applied including to facilitate the notification, allocation, processing and payment of claims or for reporting purposes, either on an interim basis until a full transfer of functionality can be achieved or on a permanent basis because of limitations in the current systems being utilized.

f. Where Lloyd's Market, commercially available or bespoke systems are being utilised to manage the business before the split is applied, it should be demonstrated how they will be utilised to facilitate the split and manage the business once the split has been effected.

g. The operation of the split RITC arrangement will not result in any policyholder detriment. For example, it should not result in policyholders having to deal with two different managing agents when making a claim or complaint or when they require changes to their policy.

4 Process for applying for split RITC approval

4.1 Initial discussion

Managing agents that are considering entering into a split RITC arrangement for a year of account of a syndicate should initially approach Lloyd's for an initial discussion. This can be done via the managing agent's Account Manager or Lloyd's Legacy Manager.

The initial contact will take the form of a meeting to discuss the high-level proposals with the managing agent of the ceding syndicate and their proposed split RITC partner if one has been identified at this stage. That meeting will focus on the rationale for pursuing a split RITC, the subject business of the proposed split, how effectively it can be segregated and any operational considerations.

4.2 Detailed proposal

Following the initial meeting, Lloyd's will request a detailed paper setting out the rational for the proposals, a detailed risk assessment along with any proposed mitigation and a detailed operational plan of how the business will be serviced if the split is approved. The managing agent should address all issues relevant to the split RITC and should highlight any unusual features or areas of particular risk. The following list sets out a list of specific areas that should be addressed in all cases:

- The rationale for the split RITC (as detailed in section 3.1)
- The proposed reinsuring syndicates for the business to be split out, including the experience and expertise they possess to manage the business
- How the business to be split out will be identified and how that identification will result in unambiguous segregation
- The legal definition of the business being split that will be used in the rule modification and the RITC contract wording
- The quantum of the business to be split out specifying the gross and net technical reserves and the type of policies and policyholders that will be split out. Confirmation should be provided as to whether the business to be split contains policies designated as High Product Risk (HPR)
- A statement as to the potential impact on policyholders and whether there is any risk of policyholder detriment and how this would be addressed (as detailed in section 3.2(g))
- Details of any business being closed where the risks are located outside the UK. The parties should be able to confirm that the reinsuring syndicate has the resources to properly manage any international regulatory requirements.
- The partial LCR required by MRC to calculate the incremental FAL associated with the business to be split out. This can be provided by completing the LCR RITC template, which is available as a csv upload on the MDC platform (via the Help Section)
- Whether the two parts of the split RITC share any reinsurance cover and, if so, how that reinsurance will be managed to apportion the recoveries (as detailed in section 3.2(b))
- Whether there are any outsource arrangements or other agreements in place that will be impacted by the split RITC and that will require variation
- How the claims and complaints handling for both groups of policyholders will be administered after the split is effected (as detailed in section 3.2(c))
- Details of the data held in respect of the business to be split out and how that will be effectively transferred (as detailed in section 3.2(d))
- Details of the adequacy of the resources of the reinsuring syndicates to take on the business. This includes both IT and systems and processes but also includes any human resourcing required. Details should be provided of any staff that are being transferred (as detailed in section 3.2(e))
- Where HPR risks are included in the business to be split details of the complaints handling processes and capability of the reinsuring syndicate
- Details of any system or manual interventions that will be required by either the reinsuring or retaining syndicate to manage the business after the split is effected (as detailed in section 3.2(e & f))

- A detailed risk assessment of the split RITC proposals, including any risks that would materialise should the split RITC not take place, along with any proposed mitigation activity

At this stage the managing agent making the application must be able to identify the proposed reinsuring syndicates. If the reinsuring syndicates have not yet been identified due to an ongoing tender process, Lloyd's will expect to be informed of the identity of the syndicates involved in the tender. Where available details of prior experience in managing split RITC or similar arrangements should be provided. Lloyd's will not endorse a split RITC proposal until the identity of all reinsuring syndicates have been confirmed.

Copies of the proposed draft RITC contract wordings should be provided with the detailed proposal. If these are not available, for example because they continue to be negotiated by the parties, a timetable for when these can be provided to Lloyd's should be given.

The detailed proposal should include a statement confirming that the proposal has been agreed by the Board of the managing agent.

4.3 Review by Lloyd's

Following receipt of the detailed proposal, Lloyd's will consider the proposal and will involve representatives from the following Lloyd's teams:

- Legacy
- Market Reserving & Capital (MRC)
- Outwards Reinsurance (ORI)
- Claims
- Customer Oversight Team
- Account Management
- Legal

Where proposals may have implications for processing through DXC, DXC will be invited to provide comments on the operational implications of the proposal. (As already noted, DXC is not able to accommodate split RITC arrangements involving splitting the RITC of a single year of account, where that would involve separating business that has claims processed and paid through DXC.)

It is likely that Lloyd's will require additional information from the applicant managing agent, which it will be asked to provide. Lloyd's may also request a meeting with the managing agent to discuss its proposal.

At this stage Lloyd's will also consider the capital impact of any proposal on the reinsuring syndicates.

4.4 In principle agreement

Following completion of Lloyd's detailed review, the proposal will be referred to the Legacy Reinsurance Group (LRG). The LRG will not agree the application at this stage, but if it considers that the proposal should be allowed to proceed, the LRG will confirm its agreement in principle.

If, however, the LRG does not believe that the split RITC is appropriate and, accordingly, that Lloyd's will not make a direction in accordance with paragraph 1(2) of the Syndicate Accounting Byelaw, the LRG will send a 'minded to' decision to the managing agent, setting out its reasons for reaching its view. The managing agent will be entitled to make representations within 14 days of receiving the 'minded to' decision, after which, if the LRG remains of the view that the application should not be allowed to proceed to the PRA, a final decision rejecting the proposal will be sent to the managing agent. The managing agent will be entitled to request a review of decision in accordance with Part M of the Underwriting Byelaw and the Requirements made pursuant to that Byelaw (which can be found on lloyds.com).

4.5 Referral to PRA

Where the LRG has given in principle agreement to the application, the managing agent will be invited to approach the PRA directly to make any application for a rule modification (see section 2.2 above).

Lloyd's will additionally prepare an assessment of the proposal which will be sent to the PRA. This will include Lloyd's assessment as to the parties' abilities to manage the operational aspects of the split RITC, assessed against the information provided by the managing agent to Lloyd's in its written application. Lloyd's will also provide confirmation that it is satisfied that it is able adequately to monitor the operation of the RITC.

The PRA will be provided with the paper and any other documentation provided by the managing agent to support its application. The PRA will also be provided at this stage with details of any related previous applications for split

RITC made by the managing agent in respect of the syndicate, including any previous decisions made by Lloyd's to reject a split RITC application.

Note that any in principle agreement by Lloyd's to an application does not indicate that agreement will also be given by the PRA, which will independently consider the application.

4.6 Lloyd's Approval

If the PRA confirms agreement to the split RITC proposal it will issue a rule modification to the managing agent. Prior to Lloyd's giving approval to the split RITC, Lloyd's will require a copy of the rule modification.

Lloyd's will at this stage also require proposed final execution versions of the wordings of the contracts for reinsurance to close (which must include the identities of the reinsuring syndicates).

Once Lloyd's is satisfied that the split RITC is suitable to be agreed (and has the PRA rule modification and the reinsurance to close contracts), the LRG will confirm Lloyd's agreement to the proposal and a letter will be issued in accordance with paragraph 1(2) of the Syndicate Accounting Byelaw which will require the entering into of the split RITC contracts in the form reviewed by Lloyd's, as provided by the parties. A copy of the direction will be provided to the PRA.

5 Post approval activities

Lloyd's will provide confirmation of the execution of the split RITC to the PRA and that all the reinsuring members have come into line. Lloyd's will continue to inform the PRA of the implementation of the split RITC, including any manual processes required to be implemented.

Following the completion of the split RITC, Lloyd's will continue to monitor implementation of the arrangement. In particular, Lloyd's will review and monitor the implementation of the reinsuring syndicate's integration plan for incorporating the RITC into its business.

The operation of the arrangement will be discussed at the quarterly Legacy oversight meetings with any legacy syndicate that provided the RITC, until such time that Lloyd's is comfortable that the split is embedded in 'business as usual' operations.

Lloyd's will have regard to available data, including reports provided by the Lloyd's Complaints team to assess the impact the split RITC is having on policyholders, if any.

Where part of the business has been reinsured to close to the successor year of the same syndicate, then a separate agenda item will be added to the engagement meetings with the managing agent to obtain reports on the management of the business.

6 Timetable and relevant deadlines

The following sets out a model timetable that Lloyd's expects applications for split RITC to follow. Lloyd's recognises that some flexibility in the timetable may be required, in view of the commercial and other factors that will impact the development of a split RITC application. Managing agents should coordinate and agree with Lloyd's Legacy Manager the timetable that they will follow. Managing agents should note that material delays beyond the dates outlined below may put at risk Lloyd's and the PRAs ability to review and approve the arrangement.

- Initial discussion – during June
- Detailed proposal – by mid-July
- Review by Lloyd's – July/August
- In principle endorsement to proceed to the PRA – early September
- Referral to PRA – early-September.
- Lloyd's Approval – Dependent on the issuance of a rule modification by the PRA