M&UR Consultation FAQ

Foreign Exchange

Q. Why is FAL being restricted to 6 currencies?

The six currencies represent the 99% of the Funds at Lloyd's held, reducing the number of currencies whilst increasing the pooled bank accounts available to members so that each of the six currencies has an underlying pooled account reduces exposure to cross currency trades and supports greater automation and operational burden thereby reducing the cost of supporting the 1% that is paid for by the whole membership.

Q. Why are Swiss Francs not included within the 6 currencies?

The six currencies are based on the current usage by members, with the 6 selected representing 99% of FAL.

Q. Why will Lloyd's not allow conversion of funds between the 6 currencies?

Conversion will be allowed within the 6 currencies, so assets can be sold and then paid into the pooled account of the desired currency.

Q. Why can assets held in GBP (e.g. within PRF) not be used to settle USD distribution losses from syndicates?

Cash held within FAL can be used to settle distribution losses in a different currency and Lloyd's will in this circumstance carry out the FX.

Q. Will funds managers be able to transact FX?

Fund managers do not hold members cash and therefore cannot transact FX. Instructions from Fund Managers to request Lloyd's to FX within the six currencies prior to placing a trade will be accepted.

Q. If a third-party fund provider has FAL in a stock denominated in a currency that is not one of the 6 currencies and has no other assets will they have to resign from Lloyd's?

No they will not have to resign but they will need to sell the stock and invest in stock in one of the other 6 currencies.

Q. Is there any objection to holding equities of another country (e.g. China, Denmark, Hong Kong) if they are traded on a recognized stock exchange in one of the acceptable currencies? An example would be Alibaba, a Chinese company traded on the NYSE in US $.

This is an example of an acceptable strategy to ensure assets remain admissible under the new requirements

Q. Can USD assets be held on the Hong Kong stock market?

Yes, as long as the exchange is a recognised exchange. In this case Hong Kong stock market is acceptable. Also USD assets are in an admissible currency.

Q. Do I have to hold a USD bank account to invest in Lloyd's so I can receive USD profits?

That is the choice of each member, the USD profits will be paid away to the agreed bank account, if a non-USD account the receiving bank will covert.

Q. Do I have to hold bank accounts in each of the currencies outside of Lloyd’s or can I just hold a GBP account?

That is the choice of each member, assets can be sold within FAL and then proceeds paid across to the GBP pooled account to be paid away to member.

Q. How will Lloyd’s manage the settlement of tax liabilities that occur in currencies other than one of the 6 currently held?

These proposals do not impact this process.

Income

Q. Why are Lloyd’s retaining dividends with Funds at Lloyd’s

To meet the feedback from members and investment managers who have requested retention to support faster reinvestment, whilst also enabling greater automation and simplification of processes.

Alongside this it was also requested that members should be able to draw out quarterly subject to criteria being met, which is what is being proposed under the quarterly corridor approach.

At the annual coming into line process, surplus in excess of ECA is available to be withdrawn or retained as a member requires.

Q. Will you allow Dividend Re-investment? i.e. instead of receiving a cash dividend, additional shares are issued?

The challenge we have is the ability to automate this process for the membership, where there can be several members holding the same stock and wish to have different options. We will look at whether we can automate this process under the new system and if possible seek to bring back this optionality for members.

Q. Will dividend payments requests from members out of their FAL be automated or will every member seeking dividends need to apply each quarter for a release. Will Lloyd’s run the corridor test and alert members if they cannot meet an auto pay request in any one quarter?

Withdrawal from FAL as part of the quarterly choice will not be automated so that each member can elect whether to withdraw surplus funds above the corridor or retain within the FAL portfolio.

Investment Managers

Q. What will happen to FAL managers that are not SWIFT enabled?

Only investment managers that are Swift enabled and can interact with Member Services digitally will be acceptable going forwards in order to improve efficiency of trade notifications, ensure prompt settlement and to automate the process.

Q. Can we buy and sell investments on our own without having to pay the large fees demanded by investment advisers?

At the moment this is not in scope although we will revisit once the current transformation programme has been delivered.

Q. Do we need to have an investment manager in place? Can we not manage on an 'execution only' basis?

Yes**.** Members can have "execution" only arrangements with investment managers to reduce fees payable. The Investment Management requirement also covers the transfer of "off market" transactions into and out of FAL for Coming into Line and releases.

Q. Do we need an investment manager if we do not wish to trade and have structured our portfolio so that we are investing for long term and do not intend to actively buy and sell.

As above. If you wish to switch holdings currently with your personal Investment Manager you will need a pre-approved IM in place.

<u>Admissible assets</u>

Q. Please explain when proposed Fund's at Lloyd's restrictions come in to place. Will members have this year to reorganise their FAL and/or will they be grandfathered?

The proposed changes to the M&URs will come into effect from 1 January 2022. Once the proposals are finalised members can re-arrange their FAL prior to the introduction of the new requirements.

Q. Can you clarify what is meant by assets which cannot be traded electronically MAY be grandfathered? Which assets qualify for grandfathering?

If a member has an existing asset that no longer meets the admissibility requirements, the asset can be grandfathered, or the member can choose to replace with a new asset.

The grandfathering would apply to all assets that would no longer meet the requirements yet currently form part of FAL.

Q. Why are bank guarantees being banned given they have served Lloyd's well in the past?

One of the aims of this transformation programme is to move to digital processing. Bank guarantees cannot be held electronically and therefore create a huge administrative burden that impact the membership. The intention is to allow BGs to be grandfathered and no longer accept new BGs. LOCs will continue to be accepted as admissible assets.

Q. Will there be a grace period for Name's to arrange for the expiry date to be extended or rescinded prior to Grandfathering?

Members have until January 2022 to rescind or extend expiry dates. After this date no further changes will be allowed.

Q. Going forward will a member be allowed to increase the value of a Grandfathered BG?

After January 2022, increases to Bank Guarantees will not be allowed.

Q. Will a member be allowed to extend the expiry date on a grandfathered BG, or will the BG have to be replaced?

As above. There will be no further changes to expiry dates post January 2022

Q. Can you confirm LOC changes will be able to be made quarterly? Does this also include new facilities? Or are they only annually?

The proposals do not change the frequency which changes to LOCs can be made, or the deadlines to enable them to be included.

Q. How will a member know in advance whether his bank is close to Lloyd's counter party limit?

All banks are aware of their counterparty limits and required to monitor their exposure to Lloyd's. In addition, any request to change a LOC must be reported to Member Services prior to the change. The exposure limits will also be monitored at this point and you will be advised if counterparty limits are at, or close to capacity.

Q. Do LOCs still require a UK confirming bank

Yes

Q. Can we access Unit Trusts investment in Ireland and Luxembourg that provide US$ dominated portfolios if you are a UK based?

Yes. providing Lloyd's is able to open the accounts for the required fund.

Asset Allocation

Q. How frequently do you intend to assess the asset risk of FAL + Technical Reserves for each member?

FAL capital charge pre-approval will be an annual process where the required FAL capital charge will be assessed. If the asset allocation moves outside the Standard SAA through market movements during the year the FAL capital charge will be assessed at the next annual date.

Q. How frequently will you monitor the SAA?

Lloyd's Treasury and Investment Management team (LTIM) monitors member asset allocations on a quarterly basis as part of Solvency II Pillar 3 requirements. However, for the FAL capital charge pre-approval process this will be struck on an annual basis in line with the coming into line process.

Q. Please will you send some worked examples of the SAA calculation using the FAL and PTF which will also include the scale of the capital charges being proposed so we can assess the impact?

See appendix to this FAQ

Q. What would be the interaction between the capital charges and the quarterly maintenance of FAL?

The capital charge and the ECA would be aggregated to give the member's assets requirements. The corridor would apply to the aggregated position.

Q. When do you expect the new SAA rules to come into effect?

It is proposed that the new M&URs come into effect from 1 January 2022. LTIM will co-ordinate with Member community to ensure that the process of calculating the FAL capital charge is clear before implementation in 2022.

Q. Will my current SAA be grandfathered or does grandfathering just apply to admissible assets.

The current SAA will not be grandfathered, a member may choose to retain their current SAA. Where this is outside of the standard SAA a capital charge will arise.

Q. The SAA of syndicates will be important to be aware of in conjunction with ECA SAA. How will this be disclosed?

See worked example in appendix. We cannot disclose other Syndicate and Member information.

Q. What are the implications if we do not wish to hold 60% of our FAL in gilts - preferring a higher equity holding?

A member can choose to hold a different SAA to the Standard SAA, there will be a capital charge depending on what SAA the member wishes to hold.

Q. Can a member choose to hold 100% in non-core assets, whatever the actual split is, and accept the capital charge accordingly.

Yes, see worked example

Q. When will you first tell us our SAA position?

As part of the pre-approval process LTIM will engage with Member to ensure FAL capital charge calculation is clear.

Q. Please clarify that 60/ 40 split refers to 60% equities and 40% bonds/fixed income?

No, 60% core / 40% non-core in line with Standard SAA is aligned to 60% fixed income exposures and 40% growth assets.

Q. Why are collateralised securities capped at 10%, especially for the AAA layers where the flow of cash flow to the end investor is much more likely to happen here than more expensive, unsecured corporate credit

A cap implies a maximum holding, however the framework allows for greater exposure although this will have to be capitalised. The 10% SAA max limit reflects liquidity issues with securitised assets despite their credit rating.

Q. Where a fund has a spread of equities and bonds, how will it be classified?

For collective investment vehicles the underlying exposures will govern which asset class they belong to. For a multi-asset fund this will be classified under alternatives (funds) category in the Standard SAA.

Q. Can you clarify why there appears to be a 50% limit on investment grade credit as this can be a capital efficient, liquid and low risk asset class.

The guidance on SAA max reflects consideration for the level of investment risk, liquidity and correlation with risk assets. The beneficial aspects of holding IG credit are reflected in the 50% limit.

Q. Will quoted investment trust structures that invest in fixed income be classified as equities given the investment trust structure?

Investment companies (investment trust structures) will be assigned depending on the underlying investments however beta (correlation to equity markets) and liquidity characteristics of investment trust will need to be considered. Please refer to CIC code for guidance.

Q. When you speak about government bonds, do you mean sovereign governments? What about U.S. state governments? Or city governments?

Yes, government bonds bucket in Standard SAA **ap**plies to Central Government bonds, Supra-national bonds, Regional government bonds, Local authorities bonds
Treasury bonds, National Central Banks.

Q. How will limits for illiquid assets work. If they increase in value by 25% (but cannot be liquidated) and are in excess of 10% will the excess be inadmissible, or subject to a charge?

Calculation of the pre-approved FAL capital charge will take place once a year.

Q. Is it your expectation that a Name who keeps 100% of FAL in equities is likely on average to have very roughly a 2% increase in the ECA?

This will depend on Group exposures if a Syndicate is fully aligned. Please see worked example 2 for quantum of charges that will apply.

Q. ETFs - will these be accepted as core assets?

This will depend on underlying exposures. ETFs are electronically traded assets so they will be admissible.

Q. Will there be a guide on CIC categories? For example, are REITs included under CIC Code 45?

Yes, CIC guidance can be found on Lloyd’s website regarding Solvency II Pillar 3 requirements. REITs are classified as CIC code 45 and as a result will be classified under Alternatives (funds) category.

<u>Coming into Line</u>
Q. Why can’t a capital test not be carried out in the fourth quarter of each year?

There will be the quarterly maintenance of assets process in the fourth quarter which will provide members with the same information currently available.

Q. Will the same CIL rules apply for capital coming through your new planned PCC structure

The intention is to have consistent rules for all members.

Q. How will the one coming into line process impact the collection of US and UK Tax forms and other requirements which normally occur at year end?

The proposals do not impact these processes.

Corridor Approach

Q. Would Lloyd's consider a corridor of 95% - 105%

Yes, if the majority of members wish a narrower band then that is something Lloyd's can accommodate. From a risk perspective we can't accept a wider than +/-10% but can adopt a narrower corridor although this would need to be applied consistently across the membership and would increase likelihood of funds having to be injected during the year.

Q. Can you only receive distribution of profits if you are above 110% of ECA.

The distribution of profits will be at the May CIL point, where a member has to be at 100% of ECA.

It is outside of the May CIL that the +/-10% corridor approach applies, which will be managed on a quarterly basis.

Q. Ignoring any resubmission, will the ECA be adjusted quarterly for FX to align with the FAL valuation?

We are currently reviewing whether the ECA can be adjusted for FX each quarter.

Q. How long will the 'window' will be open to move assets in and out of FAL each quarter?

30 days

Q. What solvency data and FAL valuation date will be used for each quarterly maintenance of FAL.

The latest available solvency position will be used for each quarter. The FAL valuation date will be aligned to the same date.

Q. Can a member increase their underwriting for the following year but not introduce additional assets until the next quarterly assessment date?

This will depend on a member's position. If the member's assets are sufficient to meet the new ECA whilst remaining within the corridor then additional assets would not be required until the next CIL.

Q. What is meant by the May quarterly maintenance of assets being issued at the same time as the coming into line statement? How can the two positions be reconciled in one exercise?

There will still be two positions but they will be issued at the same time and be considered together when assessing whether additional funds are required or are available to be released so that the member only has to do one transfer. As an example for a member with an ECA of 10m if the CIL statement shows a shortfall of 0.5m and the quarterly statement shows the member has assets of 8.7m then the CIL injection of 0.5m would take the member's assets to 9.2m and would be within the corridor and so no further injection would be required.

Cash Calls

Q. Is the 20% in addition to the FAL over and above the ECA requirements

No, a member or their advisor designates existing FAL as available to meet cash calls.

Q. Does the 20% have to be held in cash.

No any liquid assets held with FAL can be designated as part of the 20%

Q. Will there be capital gains tax implications for private members.

There will potentially be capital gains tax implications. A member can manage these implications through changing the designation of the assets within the 20% during the year and through the use of substitutions.

Q. Can a member inject new money or assets instead of having 20% designated to meet cash calls.

The intention is to use the designated 20% to meet cash calls to reduce the administrative and operational burden associated with the cash call process.

Q. Does this mean Lloyd's will need to have a mandate to be able to issue instructions investment managers to sell assets.

Lloyd's currently has this mandate under the current agreements where a compulsory drawdown is required.

Q. Should Lloyd's take into account assets held outside of FAL such as stop loss

Lloyd's can only take into account assets held within FAL.

Q. Why should an investment manager or a member's advisor decide what assets are designated to meet cash calls.

The member can choose whether they delegate this authority to their investment manager or advisor.

Economic Principle

Q. Can a member elect out of the economic principle?

If a member has a structure that on a look through basis means that the economic principle should not apply, then the member should discuss the structure with Lloyd's to determine whether the economic principle should not be applied.

165% of ECA

Q. 165% of ECA is a welcome step but does Lloyd's intend discussing with HMRC

Yes it is our intention to discuss this with HMRC.

Q. Would surplus funds be available to meet underwriting losses.

As currently, surplus funds within FAL would be available to meet underwriting losses. The member can elect to hold surplus funds or withdraw surplus at the annual coming into line process as well as on a quarterly basis subject to being in excess of the corridor.

Investcloud/digital portal

Q. What security is in place to protect online data stored in new Investcloud FAL platform?

Full penetration testing was completed prior to the implementation of the new portals to ensure that all data is protected to the required standards

Q. Where is the data stored?

At a UK based, Investcloud data centre

Q. Will the portal show our own solvency data by YoA and syndicate each quarter?

The intention is to show the quarterly solvency data by YOA and syndicate. This will be in a later roll out of the portals.

Q. Will there be functionality to include underwriting performance along with the performance report within the new portal or will it purely be FAL?

This is currently not in scope.

Q. How will the portal develop for members to use it as a self-service instrument in relation to FAL transfers

The intention is to develop a series of digital forms for asset transfer functionality within the portal. The form will create a transaction that will be validated against the rules and then approved.

General

Q. Are the proposals meant also for corporate capital or only applied to what we call "private capital".

The proposals apply to all members

Q. What training is available for fund managers, and how do they access it?

Training for Fund/Investment Managers will be provided by Lloyd’s when the new Investment Manager portal is ready to implement.

Q. How will these proposals help increase members at Lloyd’s

The design principles of the Chatham transformation proposals are simplicity, transparency and efficiency, whist providing a modern digital platform to interact with members services as well as monitor performance of participation in Lloyd’s, which will benefit existing and potential members.

Q. Can Lloyd's include within the M&URs all the deadlines and sources of information.

Where information is subject to change, such as deadlines which change each year, the information will be held on the Investcloud portal. This is to prevent the M&URs having to be changed every year. A business calendar of deadlines is currently provided to members agents and can also be added to the portal

Q. Will the central fund contribution of 0.35% of written premium be revised.

There is currently no proposal to revise the central fund contribution rate.

Q. Why do Lloyd's insist on "wet" signatures.

We have significantly reduced requirements for wet signatures and accept PDF. As part of the Investcloud build, we will be introducing digital signatures in documents to reduce this burden on members.

Q. Why is there no reference within applications for individual members and SLPs, will these type of members have to convert or leave Lloyd's

The applications section sets out the requirements for new members commencing at Lloyd's (Lloyd's has not accepted new individual member applications since 2003). Existing members that are individuals and SLPs and which are actively underwriting will not be required to convert.

Appendix – Guidance on application of the capital charge where a member elects to have an asset allocation outside of the Standard Strategic Asset Allocation

The following section looks to provide further guidance by providing worked examples which outline the calculations involved in determining the capital charges that will be applied to asset allocations outside of the Standard Strategic Asset Allocation. The spirit of the rule is to determine a level of member capital that supports the risk across the members portfolio and is aligned with Solvency II requirements.

Proposed FAL Capital Charges Framework

Introduction

- Market risk associated with the PTFs is capitalised within each member's economic capital requirement.
-
- Market risk on FAL assets is currently not captured within the member's economic capital requirements and is borne by the Central Fund regardless of the level of market risk for each member's FAL.

- Introducing capital requirements for FAL assets for those members that elect to hold FAL assets above the Standard Strategic Asset Allocation ensures equity between members with regards the level of market risk that will be borne by the central fund for each member whilst continue to allow flexibility to members.

- FAL capital requirements will apply after consideration of total exposures for members running allocations outside of Standard SAA i.e. will take into consideration the market risk across the member's PTFs and FAL (referred to as 'Group Capital requirements' in the examples below).

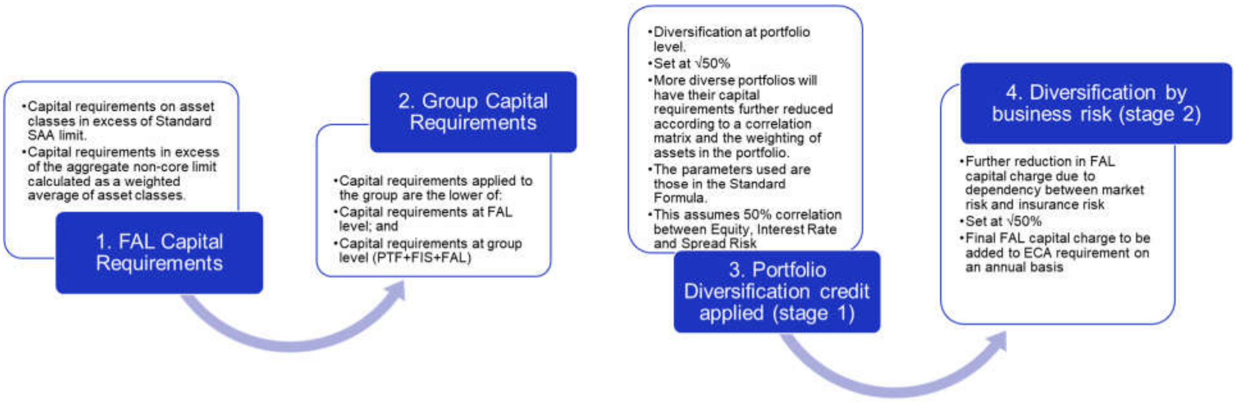
- The final capital requirement will be the lower of that applied at FAL level and that applied at aggregate level.

- A two stage diversification benefit reduction will apply where relevant to incorporate the correlation between assets in the FAL portfolio and the diversification benefit arising from the dependency between market and insurance risk as per Lloyd's Capital Guidance: *Market risk should be considered in conjunction with insurance risk, credit risk and operational risk, and the correlations recognised.*

Appendix – Guidance on application of the capital charge where a member elects to have an asset allocation outside of the Standard Strategic Asset Allocation

FAL Capital Charges - Steps involved

The diagram below sets out an outline of the process involved that will require pre-approval for Members outside the Standard Strategic Asset Allocation.



Worked example 1: Similar risk profile between Syndicate (PTF portfolio) and Member (FAL portfolio)

Syndicate assets = £1000
Member assets = £1000
Group assets = £2000
Final FAL capital charge = £1.4

Appendix – Guidance on application of the capital charge where a member elects to have an asset allocation outside of the Standard Strategic Asset Allocation

Syndicate	1000					
Member	1000					

Syndicate exposure	GBP (mn)	%	Core / Non-core
LOC	20	2%	
Cash	50	5%	85%
Government Bonds	230	23%	
IG Bonds	550	55%	
Sub-IG Bonds	10	1%	
Equities	30	3%	
Equity Funds	0	0%	15%
Alternatives	30	3%	
Collateralised securities	80	8%	
Total	1000	100%	100%

Member exposure	GBP (mn)	%	Core / Non-core	Standard SAA Max limits	Capital Charge	FAL capital charge
LOC	20	2%		30%	n/a	0
Cash	50	5%	85%	100%	n/a	0
Government Bonds	230	23%		100%	n/a	0
IG Bonds	550	55%		50%	10%	2.75
Sub-IG Bonds	10	1%		40%	25%	0
Equities	30	3%		40%	40%	0
Equity Funds	0	0%	15%	40%	40%	0
Alternatives	30	3%		40%	40%	0
Collateralised securities	80	8%		10%	30%	0
Total	1000	100%	100%			**2.75**

Group exposure	GBP (mn)	%	Core / Non-core	Standard SAA Max limits	Capital Charge	FAL capital charge
LOC	40	2%		30%	n/a	0
Cash	100	5%	85%	100%	n/a	0
Government Bonds	460	23%		100%	n/a	0
IG Bonds	1100	55%		50%	10%	2.75
Sub-IG Bonds	20	1%		40%	25%	0
Equities	60	3%		40%	40%	0
Equity Funds	0	0%	15%	40%	40%	0
Alternatives	60	3%		40%	40%	0
Collateralised securities	160	8%		10%	30%	0
Total	2000	100%	100%			**2.75**

Calculation of FAL capital charge	£m
FAL capital charge (alone)	2.75
FAL capital charge (group)	2.75
Lower of the two	2.75

Diversification benefit	£m
Stage 1 (portfolio diversification)	1.94
Stage 2 (business divesification)	1.38
Final FAL capital charge	**1.38**

Appendix – Guidance on application of the capital charge where a member elects to have an asset allocation outside of the Standard Strategic Asset Allocation

Worked example 2: Different risk profile between PTF and FAL assets

Syndicate assets = £1000
Member assets = £1000
Group assets = £2000
Final FAL capital charge = £23

Syndicate exposure	GBP (mn)	%	Core / Non-core
LOC	20	2%	85%
Cash	50	5%	
Government Bonds	230	23%	
IG Bonds	550	55%	
Sub-IG Bonds	10	1%	15%
Equities	30	3%	
Equity Funds	0	0%	
Alternatives	30	3%	
Collateralised securities	80	8%	
Total	1000	100%	100%

Member exposure	GBP (mn)	%	Core / Non-core	Standard SAA Max limits	Capital Charge	FAL capital charge
LOC	0	0%	0%	30%	n/a	0
Cash	0	0%		100%	n/a	0
Government Bonds	0	0%		100%	n/a	0
IG Bonds	0	0%		50%	10%	0
Sub-IG Bonds	0	0%	100%	40%	25%	0
Equities	1000	100%		40%	40%	240
Equity Funds	0	0%		40%	40%	0
Alternatives	0	0%		40%	40%	0
Collateralised securities	0	0%		10%	30%	0
Total	1000	100%	100%			**240**

Group exposure	GBP (mn)	%	Core / Non-core	Standard SAA Max limits	Capital Charge	FAL capital charge
LOC	20	1%	43%	30%	n/a	0
Cash	50	3%		100%	n/a	0
Government Bonds	230	12%		100%	n/a	0
IG Bonds	550	28%		50%	10%	0
Sub-IG Bonds	10	1%	58%	40%	25%	0
Equities	1030	52%		40%	40%	46
Equity Funds	0	0%		40%	40%	0
Alternatives	30	2%		40%	40%	0
Collateralised securities	80	4%		10%	30%	0
Total	2000	100%	100%			**46**

Calculation of FAL capital charge	£m
FAL capital charge (alone)	240
FAL capital charge (group)	46
Lower of the two	46

Diversification benefit	£m
Stage 1 (portfolio diversification)	33
Stage 2 (business divesification)	23
Final FAL capital charge	**23**