LLOYD'S

Performance Management - Supplemental Requirements & Guidance

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Contents

Introduction 4

Performance Management Requirements and Guidance
Franchise Guidelines 5
Overwriting 8
Rate Reductions 10
Outwards Reinsurance 11
Disclosure of Related Party and Other Transactions which May Give Rise to a Conflict of Interest 16
Distribution Costs, Broker Remuneration and Additional Charges 17
“Grossing Up”/Net-Equivalent Clauses 21
Reinsurance to Close 22
Special Termination/Downgrade and Funding Clauses 24
General insurance Contracts Involving Risks Relating to the Death of an Individual 25
Market Reform Contracts/Contract Certainty 26
Inception Date Allocation 27

Classes Subject to Additional Oversight and/or Approval
War & NCBR Exposures 28
Financial Guarantee 30
Viatical & Life Settlements 34
Retrospective Reinsurance 34
US and Canadian Cannabis Risks 35

Abbreviations

In this document, the following abbreviations have been used:

ECA:	Economic Capital Assessment
GWP	Gross Written Premium
PMDR:	Performance Monitoring Data Review
RDS:	Realistic Disaster Scenario
RITC:	Reinsurance to Close
SBF:	Syndicate Business Forecast
SCR:	Syndicate Capital Requirement

Other abbreviations are defined in the relevant section where they are used.

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 Lloyd's. Lloyd's also prescribes a number of Principles for Doing Business at Lloyd's against which the capabilities of managing agents are assessed.

In a number of areas, the Markets function 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 Market 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

While this document includes requirements and guidance that are relevant to all parts of the Markets function, the topics covered are primarily concerned with underwriting and business plan matters. This document does not cover delegated authority requirements, which are addressed separately.

This document also does not include requirements or guidance 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 manager.

Updates to this Document

This document updates and replaces the version of this document issued in July 2020.

It is intended that this document will be updated and supplemented from time to time, to reflect changes to Lloyd's requirements.

A copy of this document can be downloaded from www.lloyds.com/supplementalrequirements.

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 (subject to being updated) 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 Lloyd's.

It is not intended that the guidelines should be blindly applied to every syndicate and on every line of business. Lloyd's 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.

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 and tail risk exposure

a. Catastrophe exposure should be analysed using tools or methods that are approved by Lloyd's.

b. A Syndicate's projected and in-force loss estimates for Realistic Disaster Scenarios, shall not exceed 80% of ECA plus Profit for Gross Losses and 30% of ECA plus Profit for Final Net Losses.

c. The 99.8th percentile (1-in-500) of the insurance claims shall not exceed 135% of the 99.5th percentile (1-in-200) of insurance claims. Both measures refer to the total modelled insurance claims net of reinsurance on an ultimate basis as reported to Lloyd's in the LCR submission (Form 311). For syndicates which do not have an internal model and do not submit an LCR to Lloyd's this does not apply. Instead, the 99.8th percentile of Final Net LCM WWAP losses shall not exceed 135% of the 99.5th percentile of Final Net LCM WWAP losses and the 99.8th percentile of Final Net LCM WWAP claims shall not exceed ECA plus Profit. Final Net LCM WWAP metrics will be calculated by Lloyd's based on syndicates' latest approved LCM Forecast submissions.

'Profit' for these purposes shall be defined as 'Profit/Loss for the period' on an Ultimate basis in the approved Year of Account SBF (item 16 of SBF Form 100s).

- Guidance

In reviewing a syndicate's management of gross and net catastrophe exposures and tail risk, attention will be paid not only to overall syndicate capital, but also to:

- 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 quality, nature and effectiveness of the reinsurance protecting the gross exposures; in terms of the overall scale, types of product purchased, the legal and structural strength of the contracts involved, the financial strength and concentration levels of the reinsurance counterparties involved, and the quantity and quality of any supporting collateral arrangements
- The overall liquidity of the syndicate, and its ability to meet any expected regulatory funding requirements
- The assumptions used in modelling catastrophe exposures, and
- The managing agent's capability and competence

The purpose of this guideline is to ensure that the capital of any syndicate (and ultimately the Central Fund) should not be threatened to an unreasonable or unexpected extent by catastrophe losses.

3 Gross and net line size

The maximum gross line that a syndicate should have on an individual risk is 25% of GWP, subject to a maximum line size of £200m. The maximum net line size that a syndicate should have on an individual risk cannot exceed 30% of ECA plus profit, where profit is defined as per 2 above.

- 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 GWP, but also to:

- The GWP 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, nature and effectiveness of the reinsurance protecting the gross line size (including the overall scale, types of product purchased, the legal and structural strength of the contracts involved, the financial strength and concentration levels of the reinsurance counterparties involved, and the quantity and quality of any supporting collateral arrangements)
- Line size utilisation, and
- The managing agent's capability and competence

When reviewing the net line size in relation to the level of capital, the following aspects will be taken into account:

- Line size utilisation and the number of risks exceeding the threshold

- The risk of accumulation between individual risks
- The maturity of the syndicate and future growth plans, and
- The member structure of the syndicate.

The intent of the guidelines is that individual risks should not be allowed to threaten the viability of the syndicate, putting members and the Central Fund at risk.

For the sake of clarity it is emphasised that it is not the intention to apply guideline percentages to the premium or ECA and profit allocated to the individual line of business, but to the GWP or ECA and profit of the syndicate as a whole.

4 Casualty Reserve Deterioration

A stress of a 45% increase in the net of reinsurance reserves for all casualty classes of business should not exceed 100% of ECA for each syndicate.

- Guidance

Casualty classes of business are defined as the following three high level classes of business: Casualty FinPro, Casualty Other, Casualty Treaty. Risk code mapping can be found on Lloyds.com.

Net of reinsurance reserves for this purpose shall be defined as follows: ‘Total modelled insurance claims (including ALAE) for all underlying pure years in aggregate net of reinsurance using the balance sheet date as per latest submitted capital model. The basis should correspond to ‘Mean Net Claims’ as per LCR form 510.

Syndicates which do not submit an LCR will not be required to run this test.

If a managing agent has identified that a syndicate may breach the guideline or if it wishes to obtain a dispensation, the managing agent will be expected to address the following points:

- The reasons for breach or the requirement for the dispensation, including due to new transactions, risk mix changes or other factors leading to a change in reserve mix.
- The extent of the effect of the breach or dispensation on the syndicate's capital requirements
- Any other relevant Franchise Guideline dispensations
- Whether the SCR needs to be resubmitted

Where a managing agent fails to notify that it may breach the guideline and subsequently the LCR or other core market returns show that the syndicate has breached the guideline, Lloyd’s will, in addition to the above considerations, also wish to review the effectiveness of management controls.

5 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 reinsurance protection which matches the vertical limits to be written, the policy periods written, the terms and conditions of the inwards policies, plus the adequacy of the reinstatement protection.

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).

6 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 GWP 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 GWP for a particular class is materially greater than that stated in the most recently approved SBF for that particular class.

Overwriting, may also result in a syndicate exceeding its capacity.

The procedure for obtaining Lloyd's agreement to overwrite

If a syndicate wishes to overwrite, its managing agent must obtain prior approval from Syndicate Performance who, in conjunction with the managing agent, will determine if a revised SBF and SCR needs to be submitted.

Note:

- Managing agents should contact their Syndicate Performance Manager if they require clarification as to whether a particular variance of GWP for a class of business would be considered ‘material’. The key considerations will include the size of increase and the impact on capital requirements resulting from a change in the composition of the whole account portfolio.
- The Syndicate Performance team use the Quarterly Monitoring Return (QMB) and the PMDR Return to assess the expected premium volume for the year. The Syndicate Performance team takes into account fluctuations in exchange rates when monitoring premium volume. This ensures that Lloyd’s is comparing the plan and PMDR on as consistent a basis as possible.
- The requirement to inform the Syndicate Performance 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 deviate from the plan (paragraphs 25 and 26). 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 (as calculated based on Gross Net Premium) (paragraph 37). Writing in excess of the syndicate's approved GWP or exceeding its capacity may therefore be a breach of Lloyd's byelaws.

The implications of overwriting

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

- The reasons for overwriting – ie 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 SCR need to be resubmitted
- The profitability of any additional premium and the impact on class and syndicate performance

Where a syndicate fails to notify the Syndicate Performance team that it may overwrite and subsequently the QMB, PMDR or other core market returns show that the syndicate has actually overwritten, the Syndicate Performance 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 agreeing both business plans and SCRs.

Writing in excess of the syndicate's capacity

As noted, it is a byelaw requirement for managing agents to take reasonable steps to ensure that they do not write in excess of the syndicate's capacity. Where a syndicate is seeking permission to overwrite it will also need to consider if the overwriting will result in the syndicate exceeding its capacity (calculated on a Gross Net Premium basis). Where a syndicate is wholly aligned or has a small number of members and where all those members give express agreement, it is permissible for a syndicate to increase its capacity (referred to as pre-empting) mid-year as part of obtaining agreement to amend its plan to accommodate any proposed overwriting. Any increase in capacity should be recorded in the revised SBF.

For non-aligned syndicates with larger memberships, it will not be possible in practice to obtain the positive consent of each member to a pre-emption mid-year and so a mid-year pre-emption of capacity to allow for additional GWP will not be possible.

In exceptional circumstances, however, the Underwriting Byelaw (paragraph 37(a)) gives Lloyd's discretion to permit a syndicate to write above its capacity. Managing agents that require permission to exceed their syndicate's capacity should contact the Syndicate Performance Team. Permission will only be given where the managing agent can provide a robust justification for exceeding capacity, receives appropriate agreement from Lloyd's to any proposed change to its business plan and can demonstrate that it has sufficient capital to support the additional business. In addition, the managing agent must provide written evidence of support for the overwriting of capacity from each direct corporate participant on the

syndicate and from each of the members' agents that has one or more members participating on the syndicate.

Any agreement to exceed capacity will only be given for the remainder of the year of account in question. For the following year of account, the syndicate will be expected to write within its existing capacity or to pre-empt in accordance with the Syndicate Pre-emption Byelaw.

Managing agents are strongly encouraged to ensure they have sufficient headroom in their capacity to avoid the risk that they may exceed it.

Premium monitoring

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

- Whether GWP 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 (and any other relevant data sources), the Syndicate Performance team identifies that current GWP volume when trended for ultimate development is likely to exceed plan, the Syndicate Performance 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 Syndicate Performance team.

Rate Reductions

Rate or pricing reductions occur when there is market softening and may result in the Risk Adjusted Rate Change (RARC) achieved by a syndicate being lower than planned. In such circumstances, it will usually be the case that syndicates will either write less business than planned to maintain the same rate adequacy or that the price adequacy on business written will be less than planned, potentially resulting in a higher loss ratio than planned in the SBF. In both circumstances, there may be a consequential effect on profitability and the Insurance Risk element of the syndicate's approved SCR.

If a syndicate expects that rate or price reductions may result in its performance materially deviating from its approved business plan then its managing agent must inform its Syndicate Performance Manager who, in conjunction with the managing agent will determine if a revised SBF needs to be submitted. The agent must also assess the impact on capital and in conjunction with Lloyd's determine if a re-submission of the SCR is required.

A similar and equivalent approach will be adopted by Syndicate Performance for considering and monitoring pricing rate reductions as that set out in the section on Overwriting.

As highlighted in the section on Overwriting, the requirement to inform Syndicate Performance of any material deviation from the SBF is derived from the Underwriting Byelaw (paragraphs 25 and 26), 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.

Outwards Reinsurance

Lloyd's supports syndicates use of reinsurance to manage the insurance risks they write, subject to compliance with Lloyd's governance framework, and the effective operation of reinsurance management and control practices.

Because of the materiality of reinsurance to most syndicates' businesses, Lloyd's looks closely at syndicate reinsurance plans when agreeing SBFs and capital calculations. Lloyd's will consider whether planned reinsurance is logical, realistic and achievable, including consideration of risks to both placement execution and ultimate performance of the planned reinsurance. Outside of planning, Lloyd's will look to see whether the syndicate's approach to reinsurance could create any material prudential risks for the syndicate or for Lloyd's, in the event that the reinsurance protection(s) fail to perform as intended.

In addition to the Lloyd's Principles for doing business (Principle 3: Outward Reinsurance), and any relevant byelaw provisions, Lloyd's has prescribed the following requirements. These apply to all reinsurance arrangements that benefit or protect a syndicate.

Reinsurance leverage

Each syndicate should avoid excessive financial and strategic reliance on outwards reinsurance and should not pursue business strategies reliant on aggressive arbitrage and/or unsustainable outwards reinsurance arrangements.

Prior approval by Lloyd's is required if:

1. A syndicate intends to retain a net minimum amount of exposure for any risk it underwrites which is less than 10% of the gross line written.

2. For current/prospective reinsurance transactions: The total aggregate estimated gross reinsurance premiums (before the deduction of reinsurance commissions) allocated to any single syndicate underwriting year of account (YOA) is planned or expected to exceed 50% of the gross gross written premium for that YOA.

Prior notification to Lloyd's is required if:

3. The syndicate plans to execute any legacy or retrospective reinsurance transactions.

4 The total estimated reinsurance recoveries associated with the syndicate's Lloyd's Catastrophe Model 5 Key NatCat Peril Regions (LCM5) 1:200 Aggregate Exceedance Probability (AEP) Gross Loss (before the deduction of estimated additional reinstatement premiums, offset funds or collateral) is planned or expected to exceed 100% of the syndicate's Economic Capital Assessment (ECA).

If any of the above thresholds are crossed as a result of an unexpected change, or if there is a material increase to a previously notified position, then the managing agent should notify Lloyd's at an early stage.

Guidance

The purpose of these requirements is to ensure that syndicates:

- keep a meaningful underwriting interest in the risks they write
- avoid excessive financial dependency on reinsurance counterparties
- use their reinsurance to provide protection to books of business that will deliver a sustainable profit and do not use their reinsurance to deliver a profit through arbitrage.

Requests for approval made in respect of 1 and 2 above should be made to the Syndicate Performance team.

In the case of 3 and 4 above, while prior Lloyd's approval is not required, Lloyd's will look to undertake a risk-based review of the transaction focussing on evaluating how any potential risks have been assessed and managed by the managing agent.

It is accepted that decisions on the scale of reinsurance leverage may take place at any time during the year so managing agents should engage with their Lloyd's Outwards Reinsurance Manager as soon as they become aware of a potential triggering of these approval/notification requirements.

Managing agent submissions of SBFs to Lloyd's also present a natural opportunity to notify/engage with Lloyd's regarding proposals that trigger these requirements.

The following information should accompany any request or notification as set out at 1 to 4 above:

- The syndicate's reinsurance strategy and objectives
- The syndicate's reinsurance purchasing rationales and design criteria
- The overall monetary values of the reinsurance risk transfer
- The types of product(s) purchased, including the use of reinsurance shared with other entities (see also the requirements for Shared Reinsurance Arrangements below) and the use of potentially non-standard reinsurance (see the requirements for Non-Standard and Alternative Reinsurance Arrangements below)
- A summary of any material retained risks that are not protected by the reinsurance arrangements, either due to coverage differences or differences in period of protection
- Concentration levels with each reinsurance counterparty involved
- The value, type and nature of any supporting funding and/or collateral arrangements
- A summary of the risk transfer contract structure(s) and key terms

- The reinsurer financial strength assessments undertaken by the managing agent
- Details of the syndicate's reinsurance counterparty acceptance criteria

Lloyd's will advise if additional information is needed. Lloyd's will then form an opinion on the level of reinsurance risk potential and will advise the managing agent of any revised notification criteria, supplemental reporting, or broader actions that may be required.

Reinsurer selection

The choice of reinsurer for a syndicate is a matter for managing agents. However, prior notification to Lloyd's is required if:

Reinsurer concentration

1 A syndicate intends to purchase or renew reinsurance arrangements with a single reinsurance entity and/or multiple reinsurance entities which are within the same group of companies (i.e. reinsurance entities related/affiliated to each other through common ownership, directorship or financial and/or strategic interdependency) whether or not they are related to the syndicate, if either of the following apply:

a. the total estimated gross reinsurance premiums (before the deduction of reinsurance commissions) under all reinsurance contracts with these reinsurers in aggregate is expected to exceed 20% of any single syndicate underwriting year of account gross gross written premium.
b. the total estimated UK GAAP balance sheet reinsurance recoverables (before the deduction of offset funds or collateral) under all the reinsurance contracts with these reinsurers in aggregate is expected to exceed 20% of the syndicate's total balance sheet assets.

Reinsurer financial strength

2 A syndicate intends to purchase or renew reinsurance from reinsurers where any of the criteria in a – c below apply, subject to d:

a. The reinsurer has a financial strength rating from a recognised credit assessment/rating institution which is lower than an A-, i.e. is not considered "strong", "superior" or "excellent", and the full potential liability of the reinsurer(s) under the reinsurance contract(s) is not supported in full with low risk forms of collateral/securitisation and/or funding, subject to d below.
b. The reinsurer does not have a financial strength rating from any recognised credit assessment/rating institution, and the full potential liability of the reinsurer(s) under the reinsurance contract(s) is not supported in full with low risk forms of collateral/securitisation and/or funding, subject to d below.
c. The reinsurer has a financial strength rating from a recognised credit assessment/rating institution which is equal to or higher than an A-, but where the syndicate knows that the risk will be retroceded 100% to a reinsurer who falls within a or b above, subject to d below.
d. The criteria set out in a to c above shall only apply where the total estimated gross reinsurance premiums (before the deduction of reinsurance commissions) under all reinsurance contracts with these reinsurers in aggregate is planned or expected to exceed 2% of any

single syndicate underwriting year of account gross gross written premium.

If any of the above thresholds are crossed as a result of an unexpected change, or if there is a material increase to a previously notified position, then the managing agent should notify Lloyd's at an early stage.

Guidance

While prior Lloyd's approval is not required, Lloyd's will look to undertake a risk-based review of the transaction focusing on evaluating how any potential risks have been assessed and managed by the managing agent.

It is accepted that decisions on the scale of reinsurer participation may take place at any time during the year so managing agents should engage with their Lloyd's Outwards Reinsurance Manager as soon as they become aware of a potential triggering of these notification requirements.

Managing agent submissions of SBFs to Lloyd's also present a natural opportunity to notify/engage with Lloyd's regarding proposals that trigger these requirements.

The following information should accompany any notification to Lloyd's:

- The overall monetary values of the reinsurance risk transfer
- Concentration levels with each reinsurance counterparty involved
- The value, type and nature of any supporting funding and/or collateral arrangements
- The types of product(s) purchased, including the use of reinsurance shared with other entities (see also the requirements for Shared Reinsurance Arrangements below), and the use of potentially non-standard reinsurance (see also the requirements for Non-Standard and Alternative Reinsurance Arrangements below)
- A summary of the risk transfer contract structure(s) and key terms
- The reinsurer financial strength assessments undertaken by the managing agent
- Details of the syndicate's reinsurance counterparty acceptance criteria.

Lloyd's will advise if additional information is needed. Lloyd's will then form an opinion on the level of reinsurance risk potential and will advise the managing agent of any revised notification criteria, supplemental reporting, or broader actions that may be required.

Non-standard reinsurance arrangements

Lloyd's will only permit products that meet the legal definition of reinsurance and that provide genuine risk transfer to be considered and treated as admissible outwards reinsurance for the purpose of calculating a syndicate's net inwards (re)insurance risk.

Lloyd's prior approval will therefore be required if a syndicate intends to treat a non-standard reinsurance or alternative risk transfer arrangement as a reinsurance contract in the syndicate's insurance exposure/loss reporting, business plan or capital calculations.

For these purposes, non-standard reinsurance and alternative risk transfer arrangements include any purported contract of reinsurance or other financial instrument which it is proposed should be treated as reinsurance

by the syndicate, but which does not operate on an indemnity basis or which provides for limited or no demonstrable genuine risk transfer.

For the avoidance of doubt, parametric, Industry Loss Warranty, and/or collateralised reinsurance products would not be automatically considered as non-standard reinsurance or alternative risk transfer arrangements, provided they operate on an indemnity basis and provide genuine risk transfer.

If a contract falls within this definition, then the managing agent must submit the following to Lloyd's:

1. Evidence (including, if appropriate, legal opinions) to demonstrate clearly that the arrangement meets the legal definition of reinsurance.
2. Evidence that the managing agent's auditors have confirmed that the arrangement is being recorded appropriately in accordance with all applicable accounting and regulatory requirements.

If the above cannot be demonstrated, then the arrangement will not be admissible as a reinsurance contract and should not be considered or treated as reinsurance within the syndicate's insurance exposure/loss reporting, business plan or capital calculations.

Shared reinsurance arrangements

Shared reinsurance arrangements are any reinsurance contract where a syndicate shares any of the coverage of the reinsurance contract with other cedants, whether or not they are Lloyd's syndicates.

Syndicates with shared reinsurance arrangements must comply with the following requirements unless otherwise agreed with Lloyd's:

1. Shared reinsurance arrangements should clearly set out which elements are shared and which are not. This includes consideration of premium, limits, excess, any funding or collateral provision, and where appropriate the inclusion of a non-avoidance provision to ensure that in the event of a dispute between the reinsurer and a reinsured other than the syndicate(s), reinsurers will continue to honour their contractual obligations to the syndicate(s) and will not seek to avoid the reinsurance contract with the syndicate(s) as a result of that dispute.
2. All premiums (including reinstatement premiums and adjustments) and recoveries must be allocated in a clearly defined and equitable manner. This allocation should be reviewed in the event of material change in exposure or erosion due to actual loss during the contract period, with appropriate consideration of any impact on net risk, expected profitability and/or capital requirements.
3. The managing agent board is required to formally record that it has considered these requirements and is satisfied that each shared reinsurance arrangement:
    a. Complies with these requirements
    b. Is structurally and economically effective
    c. Is in the best interests of the members of the syndicate (see paragraph 39A of the Underwriting Byelaw).

The managing agent shall provide Lloyd's Outwards Reinsurance team with copies of the formal records.

Managing Agents should note that the payment or transfer of assets from or to each syndicate's Premiums Trust Fund accounts must be in accordance with the terms of the applicable Premium Trust Deed. A syndicate's Premiums Trust Funds are not to be used to fund the obligations of other syndicates or other non-Lloyd's reinsured entities (other than where this may be permitted by the Premium Trust Deed, for which the managing agent may require appropriate legal advice).

Inter-syndicate reinsurance

Managing agents must not permit a syndicate managed by it to reinsure or be reinsured by another syndicate managed by it, or by a related managing agent, unless:

1. The managing agent of each syndicate is satisfied on reasonable grounds that the reinsurance is in the interests of all of the members of its respective syndicate
2. The reinsurance is on terms which are fair and reasonable as respects both the reinsured syndicate and the reinsuring syndicate
3. The reinsurance is of a type and for a class of business that the reinsuring syndicate has agreement from Lloyd's to underwrite
4. The reinsurance consistent with the approved reinsurance purchasing strategy of the reinsured syndicate
5. The reinsurance has been negotiated, agreed and operated on an "arm's length" commercial basis. Where the reinsuring syndicate is the leading or sole reinsurer this should include an independent (whether internal or external) assessment of risk transfer pricing.

The managing agent(s) shall make and retain proper records of all inter-syndicate reinsurance arrangements. These should include but not be limited to a declaration for each transaction which has been signed by a member of the managing agent board and the Active Underwriter for each syndicate, declaring that 1 to 5 above have been complied with in full.

The managing agent shall provide Lloyd's Outwards Reinsurance team with copies of the signed declarations.

This requirement should be read in conjunction with the requirements for "Disclosure of Related Party and Other Transactions which May Give Rise to a Conflict of Interest".

Disclosure of Related Party and Other Transactions which May Give Rise to a Conflict of Interest

Lloyd's requires managing agents to disclose details relating to any association or current or proposed underwriting transaction which may give rise to a conflict of interest. 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 such transactions have been extended to transactions that are placed with

or through an intermediary that is a member of the managing agent's own group.

A disclosable insurance transaction will include 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.

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 the applicable Lloyd's, PRA or FCA rules.

The required transaction details, and information providing details of controls for managing conflicts of interest are collected by Lloyd's through market returns. The market returns include the definitions of related parties to be adopted for the purposes of completing the returns,

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. Any such disclosure should be made to the managing agent's Syndicate Performance Manager.

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).

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.

Distribution Costs, Broker Remuneration and Additional Charges

Placement structures and remuneration arrangements in the London market continue to evolve and increase. Whilst Lloyd's does not seek to interfere with the agreement of commercial arrangements in the market, nevertheless it is important that managing agents continue to consider properly the structure and terms of such arrangements to ensure their compatibility with relevant laws and regulations and to meet the very highest

standards in their dealings with brokers for the benefit of Lloyd's policyholders.

Bribery Act

The Bribery Act 2010 (the "Act") is in force and all managing agents must make sure that they continue to consider the implications of the Act (and the associated guidance issued by the Ministry of Justice). In summary, the Act provides that it is both an offence to offer, promise or give bribes (active offences) and to request, agree to receive or accept a bribe (passive offences). The Act also introduced corporate liability for failing to prevent bribery.

It is ultimately a matter for the board of each managing agent (taking its own external legal advice where appropriate) to ensure that any arrangement that a managing agent enters into does not breach the terms of the Act.

The consequences of breaching the Act are very serious and any criminal charges would be a matter for the Serious Fraud Office (rather than Lloyd's or the FCA). Lloyd's continues to expect managing agents to adopt a very cautious and rigorous approach to compliance having regard in particular to the following matters.

Brokerage

The payment of brokerage within the usual range is a long-standing commercial practice that has consistently been upheld by the courts as compatible with brokers' and insurers' fiduciary duties. Accordingly, Lloyd's has been advised and has concluded that it is inconceivable that agreement or payment of brokerage would lead to prosecution where the amount agreed is an amount within the usual range for the type of business in question and where the amount has been fully disclosed to the client.

Additional fees charges and commissions

Payment by the insurer of additional fees, charges or commissions (or brokerage outside the usual range) to a broker which acts for a policyholder, including under a line slip (rather than as agent for underwriters under a binding authority), raises concerns that the additional payment might be seen as inducing or influencing the broker to place business with the insurer contrary to the broker's client's best interests, or which might otherwise cause improper performance by the broker of its duties. This is particularly the case where the additional payments are calculated by reference (whether directly or indirectly) to the amount of business underwritten by the insurer or by reference to the profitability of the business.

Considerable care therefore needs to be taken before any such additional payments are agreed having regard to the underlying commercial reality of the arrangement in question rather than merely to how it is represented or described.

Accordingly, Lloyd's expects each managing agent to continue to ensure that, as a minimum, each of the following questions has been considered before additional payments are agreed to –

1. no matter how the additional payment is described, is the real commercial motivation to agree to the additional payment to secure underwriting

business or the opportunity to quote for such business? If so, the additional payment should not be agreed to without the managing agent obtaining its own legal advice which specifically addresses the commercial motivation for the additional payment.

Subject to the guidance below on line slip and binding authority arrangements, in no circumstances should additional payments be agreed, with an intermediary acting on behalf of the client, which are contingent upon the profitability of business being entered into or which are contingent upon receiving target volumes of business which represent a very high risk under the Bribery Act;

2 is the additional payment compatible with the managing agent's obligation to pay due regard to the interests of Lloyd's customers and treat them fairly at all times?

3 where the additional payment is said to be in return for any services provided to the insurer (whether for administrative services, provision of management information or otherwise) –

a. are the services of real additional value to the managing agent and demonstrably commensurate with the additional payment? If not, the additional payment should not be agreed to or arrangements should be negotiated in good faith so that the value of the service is objectively and demonstrably commensurate with the additional payment;

b. are the services fully defined and set out in a contractually binding agreement which would meet equivalent PRA and FCA outsourcing requirements (see SYSC 13.9) and (a) allow proper monitoring and control of the services, (b) allow access to the managing agent's internal and external auditors to review the provision of the agreed services and (c) make the broker legally responsible for providing the services and accepting liability for failure to do so. If not, the additional payment should not be agreed to without the managing agent obtaining its own legal advice;

4 has the broker agreed to provide clear and readily comprehensible disclosure to its clients in respect of each contract of insurance placed for each client of (a) the amount of the additional payment and (b) of any services for which they are paid? If not the additional payment should not be agreed;

5 can the broker demonstrate that it has appropriate and proportionate processes and procedures to ensure that it and its staff will continue to perform their fiduciary duties to their clients in all of the circumstances? If not, the additional payment should not be agreed to. The confirmations and undertakings that a broker provides under the model non risk transfer and risk transfer Terms of Business Agreements ('TOBA') published by LMA and LIIBA, including in relation to the Bribery Act, are likely to be sufficient for these purposes.

Where a managing agent does consider that it is appropriate to agree additional payments the managing agent must keep a clear record of how it reached that decision.

It is important that each managing agent agreeing to additional payments satisfies itself that the payment is appropriate rather than relying on the fact

that other managing agents or insurers may have agreed to enter into the same or similar arrangement.

Where an additional payment has been agreed not at managing agent level but at group level, then the managing agent should consider the above questions when considering a proposal to recharge any of the additional payment to the syndicate.

Supplementary guidance with regard to profit commission on line slips

It is understood that currently some line slips do permit profit commission for the named broker. Profit commission ("PC") represents a high risk under the Bribery Act. This is because an agreement between a managing agent and a broker which rewards the broker for placing (profitable) business with the managing agent raises clear concerns that the broker may be influenced to place business with that managing agent even where that is otherwise contrary to its duties to its client. In this regard it is important to bear in mind that under a line slip the broker remains the agent for its client (the insured). (This is in contrast to the position where a broker acts as agent for underwriters under a binding authority, which includes under a "limited" or "prior submit" binding authority.)

However, the legal risks regarding agreement of PC under a line slip are likely to be materially less where the managing agent is reasonably satisfied that –

a. the broker has expressly stated to its client that it will not be undertaking a fair market analysis when seeking terms for the client (but instead will seek to place the business under the line slip); and
b. the broker has disclosed, or will disclose, the remuneration arrangements to its client in accordance with the broker's duties under ICOBS and in accordance with any additional fiduciary duties it owes its client; and
c. the broker is, when required or requested to disclose the remuneration it receives under the line slip, expressly providing the client with details of the level of the PC and basis of calculation.

In the case where the client is separately paying its broker a fee, and the managing agent is aware of this arrangement, then the managing agent should satisfy itself that the broker is disclosing the remuneration details (including the PC) in respect of each contract of insurance whether or not the client specifically requests disclosure.

The broker is under an ICOBS obligation always to state to its client whether or not it is operating on a fair analysis basis or only dealing with a limited number of insurers (or one only) (ICOBS 4.1.6R).

In these circumstances, and where the managing agent is satisfied that the broker has appropriate processes to comply with its regulatory and fiduciary obligations and adequate procedures under the Bribery Act, the managing agent may decide that allowing PC is acceptable since the concern that the broker might improperly perform its duties to its client to seek best terms would not arise.

Supplementary guidance with regard to profit commission on binding authorities

In some cases binding authorities provide for profit commission to be payable to both the coverholder and also to the Lloyd's broker which placed the binding authority on behalf of its client (the coverholder). Where –

a. the Lloyd's broker's only role is acting for the coverholder in placing the binding authority (and not acting for the ultimate policyholders); and
b. where the profit commission arrangement for the Lloyd's broker is included in the binding authority

then there should not be a concern from the Bribery Act. This is because the broker's client (the coverholder) is a party to the binding authority agreement permitting the profit commission.

Managing agent recording of arrangements and reporting to Lloyd's

While managing agents are no longer required to submit an annual Broker Remuneration Return, Lloyd's considers that recording appropriate information is an important control to help managing agents identify, assess and manage any legal or regulatory risks arising from any remuneration arrangements (including risks under the Bribery Act). Managing agents are therefore encouraged to continue to record and retain the information required by the Return as part of their own internal controls.

Details of the return previously required and the accompanying guidance are made available by Lloyd's for use by managing agents. (Contact conduct@lloyd's.com).

In addition, managing agents must notify Lloyd's at conduct@lloyds.com prior to entering into any new agreement which:

- involves an additional payment;
- is material to the managing agent's business; and
- is believed by the managing agent to present a significant risk, even if this risk will be appropriately managed and mitigated through internal governance and controls.

"Grossing Up"/Net-Equivalent Clauses

Grossing up is a practice whereby the gross premium (ie including commission) agreed between broker and insurer (or reinsurer) is less than the premium which the broker notifies the proposed policyholder is payable. The difference between the two amounts remains in the hands of the broker and the proposed policyholder is left unaware that they are paying a greater sum than has been agreed by the broker on their behalf with the insurer (or reinsurer).

Such a practice, without the informed consent of the proposed policyholder, is wholly unacceptable and is a breach of the agency duties which the broker owes the policyholder as its principal.

In certain cases, slips have contained wordings which have allowed the broker to adjust the gross premium while the underwriter receives the same net premium (for example, contracts with an "or net equivalent" clause).

In view of the concerns that can arise from "grossing up" and the difficulties in ensuring that there is appropriate policyholder consent, managing agents should not include clauses in contracts where the commission is expressed as a net equivalent and may be varied by the broker, unless the commission appearing on the slip is expressed as a specific sum or maximum amount which can only be reduced.

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 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 and obligations to provide regulatory redress as a result of policyholder complaints) 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.

Managing agents should also note that in view of the PRA Rulebook definition of 'approved reinsurance to close', contracts of RITC to be underwritten by more than one syndicate may additionally require the application to the PRA for a modification of SII Firms – Lloyds Approved Reinsurance to Close – Rule 3.1

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 their members and Lloyd's 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.

Lloyd's recognises 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 Lloyd's believes reflect an appropriate and prudent minimum requirement.

Managing agents may wish to consider using the LMA model downgrade clauses (LMA 5139 and LMA 5140). Where managing agents choose to use other clauses, 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 Lloyd's Market Association has also produced additional information and guidance for its members on the use of these clauses.

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 PRA regulations, Lloyd's anticipates that managing agent wishing to write this type of risk will 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.

Market Reform Contracts/Contract Certainty

Market Reform Contract

The Council 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 Velonetic.

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.

3. Managing agents can find details of the applicable guidelines and details of the Market Reform Contract on the London Market Group website: www.lmg.london.

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 a UK regulated insurer, or arranged through a UK 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 (reissued in September 2018) 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. Managing agents are further reminded that the Code of Practice requires that they should be able to demonstrate their

performance in respect of Contract Certainty principles A & B (which set out the parties' responsibilities when entering into the contract and after entering into the contract).

The Code of Practice can be downloaded from www.lmg.london.

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 for combined certificates or where the risk is written solely by Lloyd's underwriters. This guidance is set out in Market Bulletin Y4133.

The London Market Group website (www.lmg.london) includes a Several Liability Decision Chart showing which several liability clause should be used in each case.

Inception Date Allocation

Inception Date Allocation (IDA) is the market practice adopted at Lloyd's for the allocation of risks to a year of account based on the inception date of the risk in question.

The proper allocation of risks in accordance with IDA can require careful consideration of the policy in question (for example where the policy is a multi-year risk or has been written under a binding authority or line slip).

As the incorrect allocation of risks can also delay the processing of submissions, Velonetic has issued a market communication providing guidance on the proper application of IDA: 'Lloyd's Inception Date Allocation (IDA) – Reminder of How to Process through Velonetic' (Reference 2018/084).

Managing agents are encouraged to refer to the guidance provided by Velonetic to ensure the proper allocation of risks in accordance with IDA. A copy of Velonetic's guidance can be obtained from Service.Centre@dxc.com.

Classes Subject to Additional Oversight and/or Approval

The uncontrolled writing of certain perils can present a material source of prudential risk for Lloyd's. The ability for exposures to aggregate means that these perils have the potential to threaten the market's financial position. Certain types of risks, if written, may also have a reputational impact on Lloyd's. Accordingly, these perils, as specified in this section, cannot be written by managing agents, or can only be written if done so in line with the restrictions set out. Any managing agent that wishes to obtain an exemption from the requirements will require the separate agreement of Lloyd's. Agreement to write these perils can be obtained through the syndicate business planning process.

War & NCBR Exposures

In this section War and NCBR are defined as follows:

- **War** - includes all war related perils, including war, civil war, invasion, act of foreign enemies, hostilities (whether war be declared or not), rebellion, revolution, insurrection, military or usurped power. War related perils, however, does not include terrorism or SRCC (strikes, riots and civil commotion).

- **NCBR** - means nuclear, chemical, biological or radioactive material used as a weapon. Losses arising from the use of NCBR weapons can occur as a result of war related perils. They can also arise from criminal or terrorist acts or incidents. NCBR perils may result in direct or indirect losses.

When can War and NCBR risks be written?

1. Except as provided for in 2. below, all insurance and reinsurance policies written at Lloyd's must contain a clause or clauses excluding all losses caused by War and NCBR perils.
2. Coverage for War and NCBR perils can only be provided in the following circumstances:

   a. Syndicates have Lloyd's express agreement through the business planning process;
   b. Where exclusions for War and NCBR perils are prohibited by reason of local legal or regulatory requirements. This does not include the writing of non-compulsory War and NCBR risks, such as reinsurance of the French GAREAT pool; or
   c. The exposures fall within one of the following exempt classes of business:
      i. Legal Expenses (LE)
      ii. All Casualty risk codes (which includes all risk codes within, Casualty FinPro, Casualty Treaty and Casualty Other) other than:
         - BBB/Crime (BB)
         - Workers Compensation (US & non US) (W4, W5 & W6)
         - Cyber (CY, CZ, RY & RZ)
      iii. All Political Risk, Credit and Financial Guarantee risk codes (PR, CF, CR FG , SB & FM)

Requirements for writing War and NCBR Risks

In all cases where coverage is provided for War and NCBR perils the following principles should be applied:

Policy language

Where cover is to be given, the scope of cover must be clearly stated. This can be most easily achieved by using a separate policy, a separate insuring clause or a separately identifiable section of the policy. 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.

Specific requirements for state-backed cyber attacks can be found in Market Bulletin Y5381 and Market Bulletin Y5433.

The LMA has developed a number of model clauses that specifically exclude or provide coverage.

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

Where local law or regulations impose requirements on how coverage should be provided for in policy documentation it is acceptable to follow those requirements.

Monitoring and control of exposure

Managing agents are required to demonstrate that they are monitoring and controlling the exposure of their syndicates to War and NCBR perils. This includes all exposures, however written by the syndicate, including where any coverage given is only included because War and NCBR exclusions are prohibited by local legal or regulatory requirements. Exposures within exempted classes should also be included when syndicates are monitoring and controlling exposures.

Syndicates should have in place processes and procedures to monitor exposures from War and NCBR perils. These exposures should be assessed against the syndicate's risk appetite for these exposures on a regular basis.

Exposure control is reviewed by Lloyd's through the provision by managing agents of the War and NCBR Return as part of the business plan and RDS processes. The War and NCBR Return should be completed for all exposures other than categories i. and ii. of the exempted classes (Legal Expenses and Casualty).

Syndicate Business Plan agreement

Where syndicates intend to write War and NCBR risks they must complete the War and NCBR Return (other than for categories i. and ii. of the exempted classes (Legal Expenses and Casualty)) and submit it as part of the syndicate business planning process. Agreement to any plans for the writing of War and NCBR will be provided as part of the business planning process. Mid-year changes to business plans in respect of War and NCBR can be made in the usual way.

Delegated underwriting

Subject to appropriately robust underwriting controls being in place for any delegated authority arrangements and subject to compliance with the requirements in the rest of this section, the underwriting of War and NCBR perils by coverholders or by way of line slips or consortium arrangements is permitted.

In all cases, underwriters should ensure that there are arrangements in place to provide them with prompt advice of exposure assumed under such delegated authorities.

Civil nuclear risks

The restrictions on NCBR coverage, as noted above, only apply to the use of NCBR material as weapons. Accordingly, the requirements 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 agreed 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

Financial Guarantee risks have long been identified by Lloyd's as a class of business that can bring a high level of prudential risk to the Society if written without proper controls. Therefore, the underwriting of this class is closely monitored and restricted.

Lloyd's operates a risk-based approach to underwriting in this class and will consider proposals on their merits through the business planning process having regard to the characteristics of the business being proposed and managing agents demonstrating that they have the appropriate controls in place.

Managing agents are therefore not required and should not seek to obtain approval for the underwriting of individual contracts unless the risk falls outside the syndicate's business plan or the managing agent has been required by Lloyd's to submit individual contracts for agreement. In all other cases, it is for the managing agent to assess that the risk is within the agreed syndicate plan and to make any decision to bind the risk. Lloyd's will return without reviewing any policies that do not meet the criteria for referral to Lloyd's.

It is important to emphasise that this approach now operated by Lloyd's, which differs from the previous more prescriptive and rules-based approach, is not intended to signal a relaxation in Lloyd's risk appetite for the writing of this class of business, which remains limited. However, by operating a risk-based approach Lloyd's can assess each proposal and managing agents are not limited in the type of risks they can write by unduly rigid rules.

Definition

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” include reinsurance) where the insurer agrees to indemnify the insured against loss, or pay or otherwise benefit the insured in the event of any of the following:

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

Included within Financial Guarantee are the following classes:

- Contract Frustration (Risk Code CF)
- Credit Risk (renamed from Trade Credit) (Risk Code CR)
- Mortgage Indemnity Insurance (Risk Code FM)
- Surety Bond Reinsurance (Risk Code SB)
- Salvage Guarantee Insurance
- Maritime Liens

For the purposes of allocating a risk code, where a risk falls within the definition of Financial Guarantee, it should only be assigned to the FG risk code where the risk cannot be properly allocated to one of the other risk codes specified for Financial Guarantee business. For example, Salvage Guarantee and Maritime Liens cannot be assigned to one of the other available risk codes and so risks in these classes would be coded FG.

Where a managing agent is considering a risk but is uncertain as to whether it falls within the definition of Financial Guarantee insurance, the managing agent should discuss it with its Syndicate Performance Manager.

Premium Income Limits

Lloyd’s will consider all business plans that propose to include Financial Guarantee insurance, in any of the above classes, individually. By way of general guidance, it is unlikely that business plans will be approved where the income arising amounts to more than 2% of the agreed Syndicate Business Plan GWP income, other than Credit Risk and Contract Frustration business where the relevant figure is 6% for each (in addition to income arising from other Financial Guarantee classes).

Credit Risk and Contract Frustration

Within Financial Guarantee, the two largest classes written at Lloyd’s are Credit Risk and Contract Frustration. These codes cover insurance that indemnify an insured, in relation to the provision of assets, goods, services and/or financing, either (1) for the non-performance of a valid contractual obligation or (2) in relation to the calling of a valid contractual bond.

In Contract Frustration, the obligor is a government entity or a commercial entity controlled and/or majority owned by a government entity(ies). In Credit Risk the obligor is a commercial entity with a majority private ownership.

It should be noted that Lloyd’s is unlikely to agree business plans where any expected obligor is an individual, unless the proposed insured contracts relate to their trade, business or profession.

In agreeing to plans for Credit Risk and Contract Frustration business Lloyd’s does not expect the risks to be explicitly linked to a trade, contract or security. Instead, business plans will be considered individually.

Additional requirements for the writing of Financial Guarantee risks

When considering proposals for the writing of any type of Financial Guarantee risks Lloyd’s will expect that the managing agent can demonstrate that the following points are addressed:

Appropriate capability and resource

The writing of Financial Guarantee classes requires a high level of technical expertise in the underlying risks. Where it is proposed that a syndicate will write any of the Financial Guarantee classes then Lloyd’s will expect the managing agent to be able to demonstrate that it has suitable underwriting resources in place. In particular, Lloyd’s will expect managing agents to have a suitably robust analytical resource to support the underwriting of any business. Managing agents should also have appropriate models in place, suitable to the types of risk being underwritten.

Assignment of policy

All Financial Guarantee policies (in whichever of the risk codes listed above) must 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 must 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.

Insolvency of the Insured

All policies must contain an exclusion in respect of any loss arising from the insolvency of the insured. In a number of territories or classes it is recognized that market practice may mean that a full exclusion is not achievable (examples of such classes include Japanese contingency, aviation contingency business, and (re)insurance of Export Credit Agencies). In such cases Lloyd’s, on a request received from the managing agent (either as part of the business plan agreement process or for individual risks outside the business plan), may agree with the managing agent the use of clauses that do not provide a full exclusion. Lloyd’s will also agree the scope of business that can be written on this basis.

Delegated underwriting

Other than where delegation is to a service company coverholder, Lloyd's is unlikely to agree plans for the writing of Financial Guarantee business in any of the classes listed where the risks are bound by way of delegated underwriting. This includes, in particular, binding authorities and line slips.

Accelerated payments

Where policies provide for the insured to be indemnified for the non-payment of a financial obligation by the obligor where the obligation in question involves the obligor making a payment at a future date or a number of payments over time (for example the re-payment of a loan in instalments) then it will be usual for the insurance backing the obligation to pay out over time in accordance with the original payment schedule. Lloyd's may agree in appropriate cases to the inclusion of provisions for the making of accelerated payments at the sole election of the insured. As a general rule, however, underwriters should, in each case, have the opportunity to agree or decline to make the accelerated payments.

Fraud

Subject to any local legal or regulatory requirements, all policies must contain a clause, or clauses, to the effect that the insurer shall have at least the remedies available under the Insurance Act 2015 in relation to fraudulent misrepresentation and fraudulent claims.

In s8/Schedule 1, the Act sets out that if a qualifying breach of the duty of fair presentation was deliberate or reckless, the insurer (a) may avoid the contract and refuse all claims, and (b) need not return any of the premium paid.

In s12 the Act sets out that if the insured makes a fraudulent claim, the insurer (a) is not liable to pay the claim, (b) the insurer may recover from the insured any sums paid by the insurer to the insured in respect of the claim, and (c) in addition the insurer may by notice to the insured treat the contract as having been terminated with effect from the time of the fraudulent act.

Contracts of surety

Underwriters are reminded that, while underwriters at Lloyd's can provide reinsurance to non-Lloyd's firms in respect of business they undertake as licensed surety bond providers (Risk Code SB), Lloyd's does not permit the direct writing of these contracts of surety. Additionally, licensing restrictions apply to this class in most jurisdictions.

Proposals that are unlikely to be agreed

In view of the nature of the risks involved, managing agents should note that Lloyd's is unlikely to agree plans that involve the writing of the following types of risks:

- Where the underlying risk is a tradeable instrument or a contract for difference
- Where the primary risk is price risk rather than credit risk, for example:
    - Currency fluctuation risk
    - Commodity price fluctuation risk

- Any Agricultural revenue protection product (under risk code AG or HA), with the exception of U.S. Multi Peril Crop Insurance reinsurance that is subsidised by the Federal Crop Insurance Corporation
- Financial market fluctuation risk
- Property/land price fluctuation risk

Viatical & Life Settlements

Viatical/Life Settlements is a class that has been identified by Lloyd's as posing potentially a reputational risk to Lloyd's.

Therefore, no syndicate should write this class without prior agreement by Lloyd's. Lloyd's will require full details of the managing agent's proposals for writing this class before approval will be given. In particular, managing agents 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;
- The operational controls in place to manage the business.
- An explanation of the products offered; and
- 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 Lloyd’s for each retrospective reinsurance contract that it proposes to write.

This section does not apply to the writing of RITC or the reinsurance of portfolios in run-off within the Lloyd’s market, which are subject to separate requirements.

US and Canadian Cannabis Risks

The guidance in this section applies to cannabis related business in the US and Canada only. The writing of such business outside of the US and Canada will require managing agents to consider the application of the laws and regulations as they apply in the relevant territory.

US Cannabis and Hemp Risks

Cannabis Risks

Currently, cannabis is listed as a Schedule 1 drug under US federal Controlled Substances Act, which means that it is not legal for sale. In addition, cash generated from the sale of cannabis may implicate federal Anti-Money Laundering laws. Nevertheless, a number of states have passed laws that permit the sale of cannabis for medicinal purposes and additionally a smaller number allow its sale for recreational purposes.

Based upon a thorough review of all positions, unless and until the sale of either medicinal or recreational cannabis is formally recognized by the Federal government as legal (as opposed to subject to non-enforcement directives), underwriters should not insure such operations in any form (including crop, property, or liability cover for those who grow, distribute or sell any form of cannabis or cover for the provision of banking or related services to these operations) in the United States.

Coverage may be provided to non-cannabis-related businesses with incidental cannabis exposures (e.g. a pharmacy or physician where a small amount of their business may include cannabis products or prescriptions) although, losses arising from such exposures should, where possible, be excluded from cover.

Lloyd’s will continue to monitor developments under US law and will reconsider this position if and when the conflict of laws is resolved.

Hemp Risks

The Agricultural Improvement Act of 2018 (the ‘Act’) – popularly known as the ‘Farm Bill’ – among other matters legalises industrial hemp. The Act reclassifies hemp to distinguish it from cannabis, affirms the legitimacy of hemp research, and establishes a framework for state and federal regulation of hemp production.

Section 10113 of the Act amends section 297A of the US Agricultural Marketing Act of 1946 to define ‘hemp’ as:

> *"the plant Cannabis sativa L. and any part of that plant, including the seeds thereof and all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3 percent on a dry weight basis."*

Section 12619 of the Act amends the US Controlled Substances Act (CSA) to exclude hemp – as defined above under the Agricultural Marketing Act – from the definition of cannabis. In addition, the section excludes tetrahydrocannabinols (THC) found in hemp from the listing of THC in Schedule I of the CSA.

Hemp is legal within the US and may be underwritten at Lloyd's. Syndicates underwriting US hemp related risks should be mindful, however, that the Act's relaxation of federal law does not equate to a complete deregulation of hemp. Further, some states' laws may be more restrictive than the federal CSA. Underwriters should therefore take steps to remain informed of the development of regulations in this area and ensure that any risks written conform to state and federal laws - this would include verifying that any applicable state or federal regulatory approvals have been acquired.

Canadian Cannabis Risks

The Canadian Cannabis Act makes it legal in Canada to produce, distribute, sell and possess cannabis, subject to compliance with the provisions of that Act. Lloyd's is satisfied that, if properly done, Lloyd's underwriters are well positioned to write Canadian cannabis business subject to compliance with local Canadian requirements.

However, as cannabis remains a Class B drug in the UK, Lloyd's has considered whether Part 7 of the Proceeds of Crime Act 2002 (POCA) is engaged by underwriters providing insurance cover in Canada. In particular, it is recognised by Lloyd's that by reason of a combination of section 328(3), 329(2) and 340 POCA, sections 4, 6, and 37 Misuse of Drugs Act 1971, the production etc. of cannabis in Canada could be said to be "*proscribed conduct*" under POCA. This raises the question whether providing cannabis related insurance could result in an offence under section 328 POCA, notwithstanding that the underlying risks have been legalised in Canada.

Having taken advice from specialist Leading and Junior Counsel, Lloyd's is satisfied that:

- Providing insurance for Canadian cannabis risks would not amount, in the circumstances under consideration, to entering into, or becoming concerned in, an arrangement which facilitates the acquisition, retention, use or control of criminal property by another person thereby breaching section 328 POCA.

- That neither POCA – nor any of its statutory predecessors – was designed to bring wholly lawful conduct such as the provision of insurance of business activity carefully legalised in another country, into its scope.

- This view is consistent with the Explanatory Notes to POCA, including for example paragraph 6 which states that the statute's purpose was to criminalise money laundering in its broadest form which "is the process by which the proceeds of crime are converted into assets which appear to have a legitimate origin so that they can be retained permanently or

recycled into further criminal enterprises" – this is far removed from Lloyd's underwriters openly and properly providing businesses in Canada with insurance against a conventionally covered ascertainable external event.

Lloyd's will therefore consider the writing of Canadian cannabis business by syndicates at Lloyd's as part of the usual business planning process. Managing agents will, however, be required to demonstrate an appropriate understanding of the Canadian Cannabis Act to ensure compliance with all local laws. Where necessary, and should there be any question as to the legality of accepting any particular risk, either under UK or Canadian laws, managing agents will be required to obtain appropriate legal advice.

Particularly in view of the proximity of the USA to Canada and the potential to write cross-border exposures, it is important that managing agents ensure that any cannabis risks have Canadian risk location only.