MEMBERSHIP & UNDERWRITING CONDITIONS AND REQUIREMENTS

LLOYD'S RESPONSE TO CONSULTATION

Dated 26th February 2021

Introduction

This document sets out Lloyd's response to the consultation on the proposed new Membership & Underwriting Conditions and Requirements ("M&URs") issued by Lloyd's on 30 November 2020. The consultation ran until 29 January 2021 and a number of responses were received from a wide variety of interested parties across the market and beyond.

For each of the topics listed below, this document provides (i) a summary of the comments received on each topic, and (ii) Lloyd's response to the comments and its proposals on how this topic should be addressed in the M&URs going forward, including where this differs from the proposals originally set out in the consultation document.

Whilst this document sets out Lloyd's response to the consultation at a high level, further work will be required to develop and finalise the detailed rules as set out in the M&URs themselves and any associated guidance. This process will be done in conjunction with a market working group, comprising representatives of the LMA, the three members' agents and a number of Direct Corporate Participants ("the Working Group"). Accordingly, a further draft of the M&URs will be provided to interested parties in due course in advance of final approval.

This document will also be used to update the PRA and FCA on the outcome of the M&URs consultation, as required under their respective rulebooks.

	Topic	M&URs cross-reference
1.	Capital requirement (including acceptable assets)	2.1 – 2.3; 3.1
2.	Coming into Line	2.5
3.	Corridor approach	2.6
4.	Strategic Asset Allocation	3.2
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6.	Cash calls/designation of assets	2.6L – 2.6P
7.	Reinvestment of income	4.1
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10.	Other – including: cessation of membership, variation/amendment of M&URs	2.5G; 10.1

1. Capital Requirement (including acceptable assets)

Summary of comments received:

- The removal of differing capital requirements/uplifts was welcomed as a move towards simplification, although clarification was sought as to exactly how the calculations would work in practice;
- A number of questions were received regarding the requirement for all FAL assets to be able to be traded electronically, including as to which current assets could be traded this way;
- Requests were received for bank guarantees and life policies to remain as acceptable assets, and for the 'grandfathering' provisions to provide for this;
- Clarification was sought on why it was necessary for Lloyd's to request information/ documentation from third party capital providers.

Lloyd's response:

Detailed guidance on the capital requirement calculations will be provided in due course, as well as guidance on the electronic trading of assets and the grandfathering provisions that will apply to other assets. It should be noted that the current M&URs already preclude the acceptance of new life policies into FAL. Lloyd's proposes that grandfathered assets will be able to remain in place indefinitely but 'user pays' charges may apply if those assets are amended (e.g. increased in value), although this would cease if the assets subsequently are able to be held or traded in a dematerialised form.

2. Coming into Line (CiL)

Summary of comments received:

- The majority of responses received on the proposal to move to one CiL process in May (with a deadline of 31 May) were supportive in principle but there were questions on how this would work in practice given the timing of other events (e.g. business planning) and whether it should occur at the end of the year;
- Clarification was also sought on specific aspects such as what valuation date would apply at CiL, what would be the timeframe to provide additional assets to clear ECA shortfalls and whether specific provisions should be made for run-off syndicates;
- Comments were received to the effect that the ability to overfund up to 165% of ECA might have implications from a tax perspective (as regards business property relief).

Lloyd's response:

Lloyd's remains of the view that a single CiL process in May is the right approach, and will engage with the Working Group to set out how this would work in practice and to respond to the questions received. Separately, it will engage with HMRC to discuss the tax implications of the overfunding provision.

3. Corridor Approach

Summary of comments received:

- A variety of views were expressed on the appropriate range for members to retain assets to cover their ECA. Some views were expressed in favour of a narrower range (95% - 105), or for the members to be able to decide, but the majority were in favour of the suggested approach of 90% - 110%;
- However, there were a number of questions seeking guidance on how the corridor approach would work in practice (e.g. how it would be monitored), and what the implications would be in certain scenarios.

Lloyd's response:

Lloyd's proposes to set the corridor parameters at the 90% - 110% range, but with a view to reviewing this after three years to assess whether it remains appropriate going forward. More detailed guidance will be provided on the actual application of the corridor approach to members' FAL requirements in due course.

4. Strategic Asset Allocation (SAA)

Summary of comments received:

- A number of comments were received on the proposed allocation to asset classes within FAL, in particular that the thresholds given were too restrictive;
- Clarification was sought on the application of the SAA, e.g. how often it would be reviewed, what would happen in the event of drawdown, etc;
- It was suggested that the SAA should apply to those assets required to cover the ECA only, with greater freedom as regards assets held above the ECA;
- Clarification was sought on how any capital loading would work.

Lloyd's response:

Lloyd's view is that the SAA is an appropriate framework for asset allocation – the SAA does not prohibit holding a different allocation, but potentially applies a capital loading where the thresholds are not met (although our modelling indicates that in most cases a load would not apply). Lloyd's will engage with the Working Group with a view to providing more detailed guidance on the application of the SAA and how the "capital loading" is calculated. It is intended that the SAA only apply to that component of the FAL which corresponds to the ECA – amounts held in FAL in excess of the ECA will be outside the SAA framework.

5. Economic principle

Summary of comments received:

- There were no objections to the ‘economic principle’ per se, and it was welcomed as a longer-term replacement for interavailability, however, clarification was sought on a number of aspects, e.g. what was meant by “economic view”;
- Requests were received for fully worked examples of how the arrangement would work in practice, for example, as regards capital setting, distribution and CiL;
- Provision of the new form FAL deeds, including the revisions to give effect to the economic principle, was also requested.

Lloyd’s response:

Lloyd’s is working with its external advisers on the technical amendments required to the FAL deeds, as well as the process by which the economic principle will be applied, and will share details (including the revised deeds) with the market in due course. Worked examples showing the impact on capital requirements within a group will also be provided.

6. Cash calls/designation of assets

Summary of comments received:

- A number of comments were received on the proposal that members designate 20% of their assets within FAL for cash call purposes, both in terms of why this requirement was necessary and how it would work in practice;
- In particular, it was thought that the requirement would be administratively burdensome to administer (e.g. who would be responsible for keeping the designation up to date), and was unnecessary given the requirement to keep a proportion of FAL in liquid assets under the proposed Strategic Asset Allocation;
- A strong preference was also expressed that members retain the ability to submit new cash on receipt of a cash call demand, rather than be required to effect a drawdown from FAL.

Lloyd’s response:

Members will retain the ability to provide new cash into FAL to meet a cash call demand. The proposed requirement that members designate a proportion of assets in FAL for cash call purposes will be taken to the Working Group for further refinement.

7. Reinvestment of income

Summary of comments received:

- Whilst there was support for retention of income, the overall view was that this should be at the option at the member rather than mandatory, with the payment of income to continue to be available to those members who request it.

Lloyd's response:

Following the feedback received Lloyd's confirms that retention of income will not be mandatory. Income will be treated in one of the two ways set out below, with members/depositors able to elect the option at (i):

(i) income to be held outside of FAL and paid away quarterly, with the automated process that currently applies to CREST income to be extended to all income received; or

(ii) income to be paid into FAL, so available for reinvestment and will count as members' assets to determine the overall capital position.

8. Foreign currency

Summary of comments received:

- It was proposed that the number of acceptable currencies be increased, in particular to include Swiss Francs;
- Concern was expressed that the new M&URs only allowed very limited FX conversion, and questions were raised as to how and when FX conversion would be allowed if (for example), sterling was held in FAL but losses were in USD.

Lloyd's response:

Lloyd's proposals regarding the number of acceptable currencies have been driven by an analysis of historic volumes. There is insufficient demand for the inclusion of currencies other than the six proposed.

FX conversion has a cost to Lloyd's, and will be limited to certain circumstances such as meeting distribution losses in the appropriate currency. The exact circumstances under which FX trades will be carried out will be discussed with the Working Group.

9. Appointment of investment managers

Summary of comments received:

- Some objections were received to the requirement that an investment manager (IM) be appointed by those members/depositors who held assets other than cash or LOCs/guarantees in their FAL, particularly where the assets were not (or only very infrequently) traded;
- Questions were also raised regarding the requirement for IMs to be SWIFT enabled, as this may increase costs for some members who otherwise have little activity in their FAL;
- Clarity was also sought on whether the appointment of group companies would continue to be allowed and the process by which the new requirements would be implemented.

Lloyd's response:

The M&URs will be revised to make it clear that a broker can be appointed on an execution-only basis, and that the appointment of group companies can continue. For compliance reasons it will be necessary for any transaction in respect of an asset in FAL to be handled by an appointed IM/broker, but Lloyd's will consider whether any options are available for this to be simplified. The IM/ broker should be SWIFT enabled.

10. Other

Other comments received include:

1. Concerns were expressed that the proposal that members who did not come into line would be ceased from underwriting was disproportionate;
2. It was suggested that the powers of authorised persons to give exemptions from/vary the application of the M&URs be properly defined, and that a procedure to resolve disputes under the M&URs be implemented;
3. Clarification was sought over the circumstances in which FAL was retained to cover tax liabilities, and the use of tax indemnities.

Lloyd's responses:

1. Lloyd's is considering an alternative approach based on the charges that would apply in the case of failure to CiL, and will provide more details in due course following discussions with the Working Group;
2. Amendments to the M&URs to address both these points are being considered;
3. This will be considered further with the Working Group.