

Implementation of the EU Directive 2003/51/EC for Lloyd's (Amending Directive 1991/674/EEC Insurance Undertaking - Annual and Consolidated Accounts)

A consultation document

August 2004



HM TREASURY



HM TREASURY

**Implementation of the EU Directive
2003/51/EC for Lloyd's
(Amending Directive 1991/674/EEC
Insurance Undertaking - Annual and
Consolidated Accounts)**

A consultation document

August 2004

© Crown copyright 2004

Published with the permission of HM Treasury on behalf of the Controller of Her Majesty's Stationery Office.

The text in this document (excluding the Royal Coat of Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Any enquiries relating to the copyright in this document should be sent to:

The Licensing Division
HMSO
St Clements House
2-16 Colegate
Norwich
NR3 1BQ

Fax: 01603 723000

E-mail: licensing@cabinet-office.x.gsi.gov.uk

HM Treasury contacts

This document can be accessed from the Treasury Internet site at:

www.hm-treasury.gov.uk

For further information on the Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 5718

E-mail: ceu.enquiries@hm-treasury.gov.uk

ISBN: 1-84532-038-7

CONTENTS

	Page
Executive Summary	3
Chapter 1 Introduction	5
Chapter 2 Syndicate Accounts Framework	9
Chapter 3 Syndicate Accounts Layout and Content	15
Chapter 4 Global Accounts	23
Chapter 5 List of Questions	25
Annex A The Structure of Lloyd's	27
Annex B Draft Regulations	31
Annex C Risk Impact Assessment	41

EXECUTIVE SUMMARY

This consultation document sets out the Treasury's proposals for implementing the Insurance Undertakings – Annual and Consolidated Accounts Directive 1991/674/EEC (the IAD) for Lloyd's as amended by the Modernisation of Accounts Directive 2003/51/EC (the Modernisation Directive).

As a result of the Modernisation Directive, Lloyd's syndicate accounts are no longer required to be prepared on a cumulative basis for three underwriting years at a time but are to be prepared on an annual accounting basis in line with other insurance undertakings in accordance with the provisions of the IAD.

The IAD was implemented for insurance companies by Schedule 9A of the Companies Act 1985 and for other 'non-company' insurance undertakings by applying most of Schedule 9A of the Companies Act 1985 to the undertakings with some modifications. We propose to take the same approach for Lloyd's, where necessary making modifications to take into account the special nature and structure of Lloyd's and Lloyd's syndicates.

As a result of implementing the IAD, the main changes to Lloyd's accounting regime will be:

- Managing agents will continue to be responsible for preparing syndicate accounts but will now have civil and criminal liability for their preparation;
- The syndicate accounts must give a true and fair view of the syndicate's financial position and profit or loss and have an auditor's opinion expressing this;
- The accounts will annually recognise a profit or loss; and
- Accounts will be filed with the Financial Services Authority as the supervising authority.

We are also consulting as to whether a reference to fund's at Lloyd's, with careful explanation as to their nature and availability, should appear with the accounts.

Chapter 2 of this consultation document sets out our proposals for the accounting framework for syndicate accounts.

Chapter 3 sets out our proposals for the layout and contents of syndicate accounts.

Chapter 4 explains our proposals for Lloyd's global accounts as an aggregation of syndicate accounts.

INTRODUCTION

Background

1.1 The Lisbon European Council of 23-24 March 2000 emphasised the need to accelerate completion of the internal market for financial services and set the deadline of March 2005 for implementation of the Commission's Financial Services Action Plan. It urged that steps be taken to enhance the comparability of financial statements prepared by listed companies.

1.2 In order to facilitate this, the Modernisation of Accounts Directive 2003/51/EC¹ ("the Modernisation Directive") amended a number of directives relating to the annual and consolidated accounts of certain types of companies, banks, other financial institutions and insurance undertakings. The amending Directive made changes to, amongst others, the Insurance Undertakings – Annual and Consolidated Accounts Directive ("the Insurance Accounts Directive" or "IAD").²

The Insurance Accounts Directive

1.3 The IAD is concerned with the presentation and content of an insurance undertaking's annual accounts and annual reports (including consolidated accounts) to shareholders and members. The IAD is not a free standing document as it applies several articles of the Fourth and Seventh Company Law Directives.³ This consultation document deals with the relevant provisions of all three Directives.

1.4 The IAD has always applied to Lloyd's but before it was amended by the Modernisation of Accounts Directive it contained an Annex which made special provisions for syndicate and aggregate accounts at Lloyd's in order to accommodate the special nature and structure of the Lloyd's market.

The Modernisation Directive

1.5 The Modernisation Directive aims to update European accounting requirements in order to bring them into line with modern accounting practices and it amends the IAD as part of the process of achieving this. One aspect of the amendments is to permit insurance undertakings to use fair-value accounting, expressed through appropriate standards issued by the International Accounting Standards Board (IASB). This is detailed in the Department of Trade and Industry's (DTI) Consultation paper.⁴

1.6 The Modernisation Directive also repeals the Annex of the IAD relevant to Lloyd's. As a result, and in line with the wishes of Lloyd's, Lloyd's and its syndicates no longer have special provisions which apply to them and the UK government needs to implement the IAD, as amended, for Lloyd's. This will be done by making regulations

¹ Directive 2003/51/EC of the European Parliament and the Council amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. OJ 17.7.2003.

² 1991/674/EEC

³ Fourth Company Law Directive (1978/660/EEC) and Seventh Company Law Directive (1983/349/EEC).

⁴ 'Modernisation Directive/ IAS Infrastructure: a Consultation Document on the implementation of the Modernisation Directive and Arrangements for the use of IAS 2004'.

under section 2(2) of the European Communities Act 1972 imposing new accounting requirements on Lloyd's and its syndicates.

Amendments

1.7 In the pre-amended IAD, the Annex provided that syndicate accounts should be prepared on a cumulative basis for 3 underwriting years of account and specified the requirements for syndicate accounts for each of the open years. This was consistent with the practice at Lloyd's of keeping years of account open typically for 36 months (unless the account is in run-off).

1.8 The Annex also provided for the preparation and content of aggregate accounts for Lloyd's, the so-called 'Globals'. This is a derogation from the Seventh Company Law Directive⁵ requirement for consolidated accounts, which applies to all other insurance undertakings. The amending Directive has retained this derogation.

1.9 As a result of the Amending Directive, Article 4 of the Insurance Accounts Directive will now read:

"This Directive shall apply to the association of underwriters known as Lloyd's. For the purpose of this Directive both Lloyd's and Lloyd's syndicates shall be deemed to be insurance undertakings.

By way of derogation from Article 65(1), Lloyd's shall prepare aggregate accounts instead of consolidated accounts required by Directive 83/349/EEC. Aggregate accounts shall be prepared by cumulation of all syndicate accounts."

1.10 The purpose of this Consultation paper is to set out the Government's proposals for implementing the Modernisation Directive for Lloyd's. Other changes made by the Modernisation Directive that do not relate to Lloyd's are not the subject of this consultation paper; the DTI has already consulted on its proposals for implementing those amendments⁶. Where our proposed legislation interacts with the DTI's proposed amendments to the Companies Act 1985, we have generally assumed that the DTI will amend the Companies Act as proposed in their consultation document. The more detailed sections of this document which discuss the proposed regulations will highlight provisions where such interaction occurs.

Current Arrangements

1.11 The IAD was originally implemented into UK legislation through several different pieces of legislation for different types of insurance undertakings. A new Schedule 9A was added to the Companies Act 1985 for insurance companies⁷. The Schedule includes prescribed formats for the profit and loss account and balance sheet, the valuation rules to be applied, the rules for determining provisions and the disclosures to be made in the notes to the accounts. There are two additional sets of regulations implementing the IAD, firstly for non-company insurance undertakings including Lloyd's⁸, and secondly for friendly societies⁹. Both these sets of regulations

⁵ Under Directive 1991/674/EEC the requirements of the Seventh Company Law Directive concerning consolidated accounts became mandatory for insurance companies, with relatively minor modifications

⁶ "Modernisation of Accounting Directives/IAS Infrastructure" 25 March 2004, URN 04/733. Available at www.dti.gov.uk/consultations or www.hm-treasury.x.gsi.gov.uk/consultations. Consultation closed 2 July 2004

⁷ The Companies Act 1985 (Insurance Company Accounts) Regulations 1993 S.I. 1993/ 3246

⁸ The Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 S.I. 1993/3245

⁹ The Friendly Societies (Accounts and Related Provisions) Regulations 1994 S.I. 1994/1983

apply Schedule 9A, or provisions very similar to those in Schedule 9A, to the non-company insurance undertakings. Lloyd's syndicate accounts are further regulated by the Society of Lloyd's under its byelaws.

Approach to implementation

1.12 The Directive will be implemented by regulations under the European Communities Act 1972, s 2(2). Draft regulations are attached at Annex B.

1.13 The move to annual accounting¹⁰ should bring Lloyd's syndicates' and global accounts closer into line with other insurance undertakings' accounts'. This move should make it easier for the industry and commentators to compare the performance of Lloyd's with its peers and create greater market transparency. Our approach has therefore been to provide for Lloyd's global and syndicate accounts to follow a format similar to individual insurance company accounts under Schedule 9A of the Companies Act 1985. However, the IAD still prescribes aggregation for Lloyd's Global accounts.

1.14 As stated at paragraph 1.11, the IAD was implemented for other 'non-company' insurance undertakings by applying most of Schedule 9A of the Companies Act 1985 to the undertakings or applying very similar provisions. We propose to take the same approach for Lloyd's. The draft regulations make most of Schedule 9A of the Companies Act 1985 applicable to Lloyd's but, where necessary, make modifications to take into account the special nature and structure of Lloyd's and Lloyd's syndicates.

We have adopted this approach of using existing provisions wherever possible for three reasons:

- It will bring syndicate accounts more closely into line with the accounts of insurance companies and other insurance undertakings. New provisions are always open to new and different interpretations and will not come with the "ready-made" case law which has decided how the various provisions of the Companies Acts work in practice;
- There are concepts and definitions within the rest of the Companies Acts, not just the specific sections dealt with in this document, which would need to be reconsidered and carefully duplicated if new provisions were not to come to an unintentionally different legislative result from that for other insurance undertakings' accounts; and
- Cross-applying the Companies Act provisions would mean that any amendments of these provisions in the future, whether required by EC law or dictated by UK policy, would be automatically tracked and applied to syndicate accounts as well. Otherwise, new provisions would need to be separately amended each time to avoid the two regimes becoming out of step.

Q 1. The details of our proposed approach to implementation are discussed in the rest of the document. Are there any comments about our general approach of using existing provisions wherever possible?

¹⁰ Announced by Lloyd's on 19th November 2003

Changes

1.15 As a result of the implementation of the Insurance Accounts Directive the main changes to the syndicate accounting regime will be as follows:

- Managing agents will continue to be responsible for preparing syndicate accounts but will now face criminal liability if they fail to prepare the accounts in accordance with the regulations;
- The accounts must give a true and fair view of the syndicate's financial position and profit and loss and have an auditors opinion expressing this;
- The accounts will annually recognise a profit or loss;
- A reference to fund's at Lloyd's, with careful explanation as to their nature and availability, will appear in the notes to the accounts; and

We are also consulting as to whether a reference to fund's at Lloyd's, with careful explanation as to their nature and availability, should appear with the accounts.

Timing

1.16 The proposed timeframe for implementation consists of a 3-month consultation period ending 29 October 2004. The new regulations will come into force on 1 January 2005 and apply to financial years commencing on or after that date.

INTRODUCTION

2.1 This chapter summarises our approach to the over-arching framework of annual accounting and analyses the various sections of Part VII of The Companies Act 1985 which we propose to make applicable to syndicate accounts for this purpose.

OVERVIEW

2.2 Under Lloyd's current syndicate accounting rules, accounts must be prepared on an underwriting year (or fund) basis. Under this basis, all premiums, claims and associated expenses are related to the business written for that underwriting year. The underwriting result is not determined until the year of account is closed, usually at the end of 36 months.

2.3 Accounts compiled on an annual accounting basis reflect the profit or loss of providing insurance cover during that year as at the end of the financial year¹¹. Premiums and claims shown on the account relate to the financial year with any adjustments to the profit or loss of providing insurance cover during earlier financial years.

2.4 Following the move to annual accounting, syndicate annual accounts will comprise:

- syndicate profit and loss account;
- syndicate balance sheet (showing technical provisions at the year end analysed as between unearned premium reserves, unexpired risk provisions and claims provisions);
- syndicate cash flow statement; and
- notes to the accounts.

Syndicate accounts will, if appropriate, now show:

- brokerage and other acquisition costs;
- premiums recognised on an earned basis, by reference to the period of risk;
- reinsurance costs matched to premiums earned; and
- provision for all claims incurred to the calendar year end made at the balance sheet date.

¹¹ Including the anticipation of losses arising on cover to be provided in subsequent periods in respect of commitments entered into prior to the end of the financial year

BASIC FRAMEWORK

2.5 For insurance companies, Part VII of the Companies Act 1985 sets out the basic framework for preparing annual accounts and reports. In line with our policy of making the accounts of Lloyd's syndicates and of insurance companies as comparable as possible we have implemented the framework for syndicate accounts by applying the necessary sections of Part VII of the Companies Act 1985 to syndicates through our regulations. This mirrors the approach taken for other non-company insurance undertakings in the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993.

ACCOUNTING STANDARDS

2.6 Under EC Regulation (EC) No. 1606/2002 (the IAS regulation), all companies whose securities are traded on a regulated market in the EU will be required to prepare their consolidated financial statements in accordance with IAS (International Accounting Standards) from January 2005.

2.7 On 17 July 2003 the DTI announced that from January 2005, the option to use IAS as an alternative to UK Generally Accepted Accounting Standards (UK GAAP) on a voluntary basis would be extended to all British companies for their individual accounts and to unlisted British companies for their consolidated accounts. However, the FSA are consulting on allowing (but not requiring) entities to adopt IAS for the completion of their regulatory returns.

2.8 In Lloyd's statement to the market dated 19 November 2003 they announced their proposals to adopt UK GAAP initially with a move to IAS as the UK Accounting Standards Board (ASB) brings the two sets of provisions substantially into line. We have not provided for IAS to be used as an alternative to UK GAAP for Lloyd's accounts at the moment given their plans to use UK GAAP and the FSA's intention not to require the use of IAS.

ACCOUNTING PRINCIPLES

2.9 The Modernisation Directive has, by removing the Annex to the IAD, required Lloyd's and its syndicates to adopt the same accounting principles as other insurance undertakings. This change means that the following principles now need to be applied in the preparation of Lloyd's accounts:

- the syndicate is presumed to be a going concern;
- the accounts must be prepared on an accruals basis; and
- the accounts must give a true and fair view of the undertaking's financial position.

2.10 Lloyd's accounts are not currently required to be prepared on a going concern basis. The IAD will require them to be in future, although it does allow departure from the going concern principle (i.e. presumption that the company is carrying on its business as a going concern) provided there is full disclosure of the reason for such a departure, its financial impact, and the accounts still give a true and fair view.

2.11 Accounting standards require that income and charges relating to the financial year, irrespective of the date of receipt or payment, should be accounted for (on an accruals basis). Currently, for open years of account, syndicate accounts are prepared

upon a “cash receipts and payments basis”.¹² Going forward all accounts should be prepared on an accruals basis.

True and fair

2.12 Article 1 of the IAD requires annual accounts to give a true and fair view of the company's assets, liabilities, financial position and profit or loss.¹³

2.13 The Directives do not prescribe a definition or details of true and fair. The principle is given substance by the UK law and the relevant accounting principles. Guidance as to what the principle means is given through standards such as UK GAAP and ABI SORP (Association of British Insurers Statement of Recommended Practice).

2.14 Where the application of the provisions of the IAD would not be sufficient to give a true and fair view, additional information must be given. Where, in exceptional cases, the application of a provision of the Directive is incompatible with the true and fair obligation, that provision must be departed from to give a true and fair view. The reasons for any departures and its financial effect must be disclosed in the notes.

2.15 Lloyd's syndicate accounts are currently prepared in accordance with the Lloyd's Syndicate Accounting Rules. Under those rules, syndicates have only previously provided a true and fair view of the result of the closing year of account.

2.16 With the move to annual accounting, auditors will have to be able to provide a true and fair view on the calendar year syndicate accounts (prepared in accordance with relevant schedule of the amended Companies Act). The opinion will now need to be similar to that provided on insurance company accounts.

DUTIES OF MANAGING AGENTS

2.17 For companies, the obligations to prepare accounts, to ensure they are audited etc. have been placed on Directors because of the level of control they have over a company's affairs. In relation to company accounts, duties are placed on Directors in relation to:

- proper preparation;
- disclosure of benefits;
- approval and sign off;
- auditing; and
- publication.

2.18 Syndicates do not have Directors or other officers in the way that companies or Friendly Societies do; they are fundamentally different in nature because they are unincorporated and without legal personality. Managing Agents have the sole management and control of the underwriting business they conduct for the members of a syndicate. They therefore have a similar level of control over a syndicate's affairs to that of the Board of Directors in relation to a company's affairs. We believe all of these duties required of Directors, except publication of accounts, should, in the case of

¹² Apart from material reinsurance recoveries due but not received on claims paid which are accounted for on an accruals basis and the closing year of account

¹³ Article 1 of the IAD applies Article 2 of Fourth Company Law Directive to insurance undertakings

Lloyd's syndicate accounts, be placed upon Managing Agents, with the necessary modifications. The Managing Agent is most suited to the obligations that arise in the Directive and they are already responsible for producing syndicate accounts under the relevant Lloyd's byelaws.

2.19 The sections of the Companies Act 1985 we plan to make relevant to Managing Agents and the reasons why are detailed below.

Duty to Prepare Accounts

2.20 In line with the UK obligation on Directors,¹⁴ we propose to require Managing Agents to prepare for each financial year for the syndicate:

- a balance sheet as at the last day of the year; and
- a profit and loss account.

The syndicate accounts must give a true and fair view of the syndicate's assets, liabilities, financial position and profit or loss and comply with the Regulations. The accounts are required to give extra information, if complying with the statutory format would not be sufficient to give a true and fair view. If, in special circumstances, compliance with the statutory format or the Regulations would be inconsistent with a true and fair view then the Managing Agents (like Directors) are obliged to depart from the layout to the extent necessary to give such a view. Particulars of any such departure and the reasons for it must be given in a note to the accounts.

Disclosure of Benefits

2.21 The IAD requires disclosure of emoluments granted to persons described as "administrative, managerial and supervisory bodies".¹⁵ The Companies Act requires the disclosure of benefits paid to directors and officers of a company in the notes to the accounts.¹⁶ We believe that in the case of a syndicate the same requirement should be made applicable to Managing Agents and their Directors, the active underwriter for the syndicate and any run-off manager for the syndicate, in so far as such emoluments are referable to a particular syndicate. We believe this information should be available for inclusion in the report and that it would make any potential conflicts of interest more transparent. Further consideration should be given to anybody else covered by these terms.

Q 2. Should emoluments and other benefits of Directors of Managing Agents be disclosed in the syndicate accounts?

Q 3. Should the emoluments of anyone else be disclosed?

¹⁴ Section 226 Part VII Companies Act 1985 implementing Article 2 (1978/660/EEC) made applicable by Article 1 (1991/674/EC)

¹⁵ Article 43 (12) and (13) (1978/660/EEC)

¹⁶ Section 232 Part VII and Schedule 6 Companies Act 1985

Approval and signing of Accounts

2.22 Our proposal is that Managing Agents, like Directors for companies, should be responsible for approving and signing company accounts. The draft regulations therefore apply section 233 of the Companies Act 1985 to syndicate accounts with that modification.

Duty to prepare annual report

2.23 The IAD requirement to prepare an annual report containing a fair review of the development and performance of the company¹⁷ is placed on Directors in the UK. Directors are required to prepare, approve and sign a Directors' report. The legislation sets out the required contents¹⁸. The report is supposed to contain a fair review of the development of the business of the company during the relevant financial year. The Government proposes to make the relevant provisions applicable to Managing Agents with the necessary modifications.

Auditing

2.24 The IAD prescribes how the audit report should be prepared.¹⁹ The Companies Act imposes a duty on a company to obtain an auditor's report on the annual accounts and state with what the auditor's opinion should deal, the signature of the audit report by the auditors and the duties of the auditors in compiling their report.²⁰ Again in order to implement the Directive for Lloyd's we believe these provisions should be made applicable to syndicate accounts with the necessary modifications.

Publication

2.25 Member States are given a choice, in Article 68 of the Directive, whether to require insurance undertakings to publish annual accounts or to make copies of their accounts available to the public at their head office. We intend to require Lloyd's to make copies of the accounts available (see Regulation 5 Appendix B).

Q 4. Should the duties of Managing Agents be as we describe?

FILING OF ACCOUNTS AND SANCTIONS

2.26 At the moment, syndicate accounts are filed with the Society and that body enforces the relevant accounts requirements. We believe that going forward a relevant authority should be responsible for the scrutiny of the accounts. We believe that the Financial Services Authority (FSA) is best placed to assume this role.

2.27 Sanctions are imposed for failure to comply by making anyone who approves such accounts, knowing that they do not comply or being reckless as to their content, liable to prosecution and a fine. We believe similar sanctions should apply to those responsible for the production of syndicate accounts and consequently similar

¹⁷ Article 46 (1978/660/EEC) amendments to the article are being implemented by the DTI through the Operating and Financial Review and Directors' Report Regulations

¹⁸ Section 234 and 234A Part VII and Schedule 7 Companies Act

¹⁹ Articles 51 and 51a (1978/660/EEC)

²⁰ Sections 235 – 237 Part VII Companies Act 1985

provisions should be applied to Managing Agents. Our draft regulations impose individual criminal penalties on Managing Agents which are on a similar basis to those applied to Directors of a company. In line with making syndicate accounts comparable to company accounts, the Government proposes to make individual officers of the reporting entity responsible for ensuring accounts are produced in line with the IAD requirements.

Q 5. Should the FSA receive and scrutinise the accounts?

Q 6. Should sanctions be imposed upon the Directors of Managing Agents?

ADDITIONAL SECTIONS OF COMPANIES ACT 1985 TO BE CONSIDERED

2.28 There are several sections of the Companies Act that are applied to the accounts of non-company insurance undertakings through the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations.

2.29 The Companies Act defines ‘financial year’ by reference to accounting periods²¹ which are defined for non-corporate bodies in their constitutions. Syndicates do not have constitutions. Therefore, to provide certainty of definition we believe it is necessary to set out in the regulations that the financial year for syndicates will follow the calendar year, as is the case at present, meaning each period of 12 months beginning with 1st January (see Annex B Regulation 2).

2.30 Applying Section 242B to syndicates will allow them to show the amounts in their annual accounts in ECUs as well, as required by the Directive.

2.31 Section 255 should be made applicable in line with our chosen legislative implementation route. This section sets out the special format in Schedule 9A as being applicable to insurance company accounts instead of Schedule 4.

²¹ Section 223 Part VII

3

SYNDICATE ACCOUNTS LAYOUT AND CONTENT

INTRODUCTION

3.1 This chapter explains our approach to the implementation of the IAD for the format and content of the Balance Sheet and the Profit and Loss account. In this section we explain and analyse the sections of Schedule 9A of The Companies Act which we propose to make applicable to syndicate accounts for this implementation.

3.2 As previously stated we propose to apply the relevant sections of Schedule 9A of the Companies Act to syndicate accounts, with the necessary modifications. The majority of this is straight forward as Schedule 9A was used to implement the Directive for insurance companies.

BALANCE SHEET FORMAT AND CONTENT

3.3 Schedule 9A implements Article 6 of the IAD for insurance companies by setting out the required layout for the balance sheet. This layout is applied to other undertakings through the Miscellaneous Insurance Undertakings Regulations. In the interests of consistency, we therefore propose that Lloyd's balance sheets should follow the same format (See Annex B Regulation 3)

Balance Sheet Member State Options

3.4 Several of the Articles give Member States options with regard to implementation. These options were considered by the DTI when it developed Schedule 9A. We propose to implement the same options for Lloyd's to keep the accounts similar to other insurance undertakings, unless there are substantive reasons to adopt a different approach. Instances where there are potential issues are discussed below.

Adaptation of the layout

3.5 Member States have an option to either permit or require adaptation of the Balance Sheet or Profit and Loss account, in order to include the appropriation of profit or treatment of loss.²² We propose to adopt largely the same approach for Lloyd's as for companies,²³ in that syndicates will be required to show separately on their profit and loss account any amount set aside or proposed to be set aside, withdrawn or proposed to be withdrawn, from reserves.

Valuation

3.6 The general principle is that items are valued either at purchase price or by production cost.²⁴ Member States may permit different methods of valuation to be used for certain classes of assets as long as undertakings provide some extra information in the notes of the accounts.²⁵ In Chapter 2 of Schedule 9A the UK has chosen to permit

²² Article 6 of the Fourth Company Law Directive (1978/660/EC)

²³ The Companies Act 1985 Schedule 9A paragraph 5

²⁴ Articles 32 and 33 of the Fourth Company Law Directive (1978/660/EC) deal with how items in the accounts are to be valued

²⁵ Article 33 Fourth Company Law Directive (1978/660/EC)

companies to use some of the permitted alternative valuation methods. Many assets may be included in the accounts at current (or market) value. We propose to implement the same provisions for Lloyd's.

3.7 When the DTI's proposed amendments to Schedule 9A, implementing the Fair Value Directive, come into force later in the year, Lloyd's accounts will have the further option of using that method of valuation for the specified items.

Provisions for Claims Outstanding for Non-Life Business

3.8 In relation to provisions for claims outstanding for non-life business, Member States have options at Article 60(1)(a) and 60(1)(e) of the IAD in relation to how these amounts are calculated and disclosed. Paragraph 47 of Schedule 9A takes a permissive approach and allows insurance companies to choose the method of cost assessment and to choose either to disclose these amounts as assets or to deduct them from the provision. We propose to apply the same permissive approach for Lloyd's by applying this part of Schedule 9A to its accounts.

Balance Sheet Issues

3.9 There are some balance sheet headings that need to be considered in some more detail. As mentioned previously, these headings were formulated primarily for the purposes of insurance companies. Therefore, we need to consider carefully their application to the Lloyd's market. The cases in question are discussed below.

Subscribed Capital or Equivalent Funds

3.10 Article 19 of the Directive defines this as all amounts which are regarded by the national law of the Member State as equity capital subscribed by shareholders or other persons. Schedule 9A accordingly describes this as "Called up share capital or equivalent funds".

3.11 The Annex currently excludes items such as subscribed capital, share premium reserves and reserves from the balance sheet of Lloyd's accounts and instead requires the disclosure of certain types of capital i.e. names' personal resources and Lloyd's central resources in the Global accounts only. The Modernisation Directive removes this provision.

3.12 Going forward the balance sheet will need to show any equity capital subscribed by shareholders or other persons. Clearly, syndicates do not have shareholders at all, nor do they have equity capital in the same way as companies. It is necessary, however, to consider if any of the capital underpinning the business should be disclosed as being equivalent to equity capital. We have considered whether funds At Lloyd's (FAL) should be considered as "equivalent funds". FAL are held centrally, they relate to all the business a member underwrites (potentially through participation in various syndicates) rather than the business underwritten by a particular syndicate. The funds are not hypothecated to any specific syndicate participation by a member. Therefore, there are no specific sums available to a syndicate which can be precisely identified as its capital.

3.13 For an accurate reflection of the accounts, in line with the overall requirements of the Directive, we believe it may be worth considering whether FAL should be included somewhere with the accounts. We would like to consider ways that the accounts can reflect the existence of FAL as one part of the chain of security. We

recognise FAL are held by Lloyd's centrally and would consequently expect any reference to explicitly explain their contingent availability.

3.14 Whilst we recognise it is not feasible to include any reference to FAL on the balance sheet, we think there is potential to include useful information on FAL in either the notes to the accounts, Managing Agent's report or the review. Drawing on ideas from the FSA's prudential consultation (CP 04/7)²⁶, one option could be to require syndicate accounts to be prepared reporting the 'balancing amount' as a proxy figure for FAL somewhere in the accounts. There would need to be a careful explanation included of how the balancing amount was reached and the fact that it was not capital which was assigned to the syndicate, nor which belonged to it.

3.15 The 'balancing amount', in the FSA's proposals, is the amount of capital which is needed to support syndicate-level risks but which is in excess of that held within the syndicate itself.

More specifically, the balancing amount:

- Is the difference between the Individual Capital Assessment (ICA)²⁷ and the amount of capital (net assets measured according to FSA rules) that is held within a syndicate for that syndicate period; and
- It comprises funds at Lloyd's, central assets and negative adjustments where funds at Lloyd's are reduced by the diversification effects at member level determined by the Society.

3.16 The FSA envisage in their draft rules that the Society will take account of the balancing amounts in calculating the amount of capital resources it needs to hold centrally. All the proposed rule changes should take effect from 1 January 2006.

3.17 The proposal captures FAL and centrally held assets including an adjustment for diversification of membership. We believe this will have the benefit of providing a more accurate reflection of the capital available to a syndicate.

Q 7. Should funds at Lloyd's be reflected somewhere in the reported syndicate accounts?

Q 8. How should funds at Lloyd's be reflected?

Reserves

3.18 Article 20 of the IAD specifies the types of reserve which must be shown in the Liabilities on the Balance Sheet. The Directive allows Member States to specify other types of reserves if it is necessary for undertakings which are not companies. These reserves are separate from the technical provisions required later in the Directive. Schedule 9A includes, under Liabilities A(IV) reserves:

1. Capital redemption reserve
2. Reserve for own shares
3. Reserves provided for by the articles of association

²⁶ Lloyd's: integrated prudential requirements, and changes to auditing and actuarial requirements including feedback on CPI 78 April 2004 - http://www.fsa.gov.uk/pubs/cp/cp04_07.pdf

²⁷ Firms themselves will assess how much capital should be held to support the risks of their business

4. Other reserves

We believe only undistributed profits in relation to open years of account will be reported in this section. If there are any Lloyd's specific issues which would need to be reported in this section, they could be reported within the remit of 'Other reserves', so we propose to apply this part of Schedule 9A without adaptation.

Technical Provisions

3.19 At present, through a derogation in the Annex, syndicate accounts do not have to include technical provisions. This aspect of the insurance business is accounted for through Reinsurance to Close (RITC) on a 36 months basis together with open years of account reporting the excess of premiums collected over claims and expenses.

3.20 Lloyd's will now have to comply with the technical provisions in the Balance Sheet format prescribed in Article 6 and the contents of the provisions outlined in Articles 56 to 60 namely:

- Provisions for unearned premiums
- Claims outstanding
- Other technical provisions (unexpired risk)

3.21 Schedule 9A paragraphs 43 to 48 implement these articles and it is our intention to make them applicable to syndicates as they stand. Lloyd's syndicates are already required to calculate like provisions as part of the annual solvency test. Compliance with these requirements should therefore be achieved without major difficulties.

Q 9. Do you agree with our approach to the layout and contents of the balance sheet?

PROFIT AND LOSS FORMAT/CONTENT

3.22 Schedule 9A implements Articles 33 and 34 of the IAD for insurance companies by prescribing the layout for their profit and loss account. This layout is applied to other insurance undertakings through the IAD (Miscellaneous Insurance Undertakings) Regulations. In the interests of consistency we therefore propose that Lloyd's profit and loss accounts should follow the same format.

Profit and Loss Member State Options

3.23 The instances where there are potential issues regarding Member State options are discussed in the section below.

Treatment of Unearned Premiums for Life Assurance

3.24 Member States are given an option with regard to the treatment of unearned premiums for life assurance.²⁸ Member States can either permit or require the change in the provision for unearned premiums to be included in the change in the life insurance provision. The UK has adopted a permissive approach allowing them to adopt either of

²⁸ Article 37 Insurance Accounts Directive (1991/674/EEC)

the treatments permitted by the IAD.²⁹ We propose that the same permissive approach should be adopted for syndicate accounts.

Acquisition Costs

3.25 Member States are given an option in relation to where policy renewal commissions are to be included in the profit and loss account.³⁰ The IAD allows Member States to require insurance undertakings to include policy renewal commissions at one of two locations in the profit and loss account. In previous implementation the UK has included renewal commissions under administrative expenses for long-term business only, there is no such requirement for general business. Through applying this provision of Schedule 9A to syndicate accounts the Government intends to adopt the same approach for Lloyd's.

Other Investments

3.26 Member States have an option allowing companies to choose how to disclose "Other investments".³¹ Schedule 9A allows companies to choose how to disclose other investments and making the necessary requirement for assets under item D.³² Again, we can, at present, see no reason to adopt a different approach for Lloyd's and we therefore intend to adopt the same approach for this implementation with the necessary modifications.

Profit and Loss issues

3.27 There are some Profit and Loss issues that need to be considered in some more detail. As mentioned previously, some of these headings were formulated primarily for the purposes of insurance companies. Therefore, we need to consider carefully their application to the Lloyd's market. The cases in question and some additional issues are discussed below.

Profit or Loss Realisation

3.28 With Lloyd's current 3 year accounting, no profit or loss figure is realised until the account is closed (usually at the end of 36 months). At this stage either profit can be distributed to members or, where there is a loss, a cash call may be issued to members.

3.29 Annual accounting will lead to a yearly realisation of profit or loss on the calendar year account. Managing Agents will be reporting the results of the syndicate, reflecting the profit or loss in respect of all premiums earned during the accounting period (i.e. calendar year) together with any adjustments during that period to estimates made in prior accounting periods.

3.30 It is for the Society to prescribe on what terms and when any of this profit or loss should be distributed or called from members.

3.31 We are aware that Lloyd's will continue with the practice of only closing accounts through Reinsurance to Close (RITC) after 36 months (or longer if in runoff). Therefore, application of Schedule 9A will result in a yearly profit and loss figure

²⁹ Sub paragraph 3 of the notes on profit and loss format in Schedule 9A Companies Act 1985

³⁰ Article 40 Insurance Accounts Directive (1991/674/EEC)

³¹ Article 44 of the Insurance Accounts Directive (1991/674/EEC)

³² Sub paragraph 9 of notes on the Profit and Loss format in Schedule 9A Companies Act 1985

composed of different underwriting years and interim profit or loss realisation for the underwriting year prior to closure of the account.

3.32 Currently syndicate accounts include a breakdown of the figures by underwriting year of account. The accounts provide details of the result of the closing year of account and cash balances on the open years of account. Going forward an annual account for a calendar year would not provide these details. As syndicates are annual ventures with potential different membership and business per year we believe an analysis of the result as between the individual underwriting years of account together with comparative figures should be included in either the notes to the accounts or the Managing Agent's report.

3.33 We think this information would seem to be important to an understanding of any syndicate years' business. The figures reported in the accounts may otherwise be misleading as to the state of affairs of each annual venture at the time the accounts are reported.

Q 10. Do you think a breakdown of figures by underwriting year of account should be included in the notes, reports or review of the accounts in some way?

Q 11. In what way do you think a breakdown of figures by underwriting year of account should be reported?

Technical and Non-Technical - Life and Non-Life

3.34 The Directive requires the accounts to report the distinction between:

- technical account non-life business;
- technical account life-assurance business; and
- non-technical account.

Similarly, the Directive requires the layout of the profit and loss account to make the same distinction (where the difference is material).

3.35 Previously Lloyd's syndicate accounts have not had to distinguish between classes of business (life or non-life), or differentiate technical and non-technical accounts, to comply with Lloyd's byelaws. However, as prescribed in the Lloyd's Sourcebook (LLD), the Society may not permit any syndicate to carry on both long-term insurance business (life) and general insurance business.³³ Therefore, there should be no issue with regard to this Member State option.

3.36 At present no distinction is made on the face of the accounts between technical and non-technical entries. Going forward this distinction will be required. However, it can be argued that all syndicate business is insurance-related (hence technical) due to their structure. Syndicates conduct no other business and all investment income is related to the insurance written and available to fund claims if necessary.

3.37 In the proposed regulations, both these sections of the legislation are applied to Lloyd's.

³³ Rule 9.2.4 Lloyd's Sourcebook (LLD)

Q 12. Do you agree with our approach to the layout and contents of the profit and loss account?

SCHEDULE 9A CROSS APPLICATION IMPLEMENTATION

3.38 Some paragraphs of Schedule 9A of The Companies Act impose additional requirements on insurance undertakings regarding the form and content of their accounts which are not included in the Directive.³⁴ Some of these have been applied to other insurance undertakings by the IAD (Miscellaneous Insurance Undertakings) Regulations and some have not. For consistency with other undertakings, our general approach would be to apply the provisions to Lloyd's unless they are not relevant given the nature and structure of Lloyd's. Those sections are discussed below.

Provisions to be Applied

3.39 Paragraph 41 of Schedule 9A applies where the purchase price of any asset in the accounts is not known and its cost cannot be determined without unreasonable expense or delay. It permits the accounts to ascribe to that asset a cost the same as the value ascribed to it in the earliest available record of its value made on or after its acquisition by the company. Where the cost of an asset is being determined for the first time³⁵, there must be particulars of that determination given in the notes to the accounts. These provisions seem to plug a potential gap and we have therefore included them in the provisions which will apply to syndicates.

3.40 Disclosure in the notes to the accounts of the total amount of commissions for direct insurance business accounted for in the financial year, including acquisition, renewal, collection and portfolio management commissions³⁶ will be required.

3.41 Paragraph 10(2) will apply, requiring syndicates which carry on long-term business to show separately in the balance sheet, or the notes to the accounts, the total amount of assets representing the long term fund.

3.42 The accounts must state whether the accounts have been prepared in accordance with applicable accounting standards, and particulars of any material departure from those standards and the reasons for it are to be given.³⁷

3.43 Syndicates will be required to provide extra information on the balance sheet in relation to assets which are valued on a current cost or current value basis in accordance with paragraphs 22 and 23 of Schedule 9A.³⁸

3.44 Syndicates will be required to provide the same further details which companies are required to provide in relation to items shown as investments in the balance sheet, namely how much of the investment amount is ascribable to listed investments.³⁹

³⁴ Paragraphs 10, 41, 63, 64, 65, 72, 73, 78

³⁵ Paragraph 72

³⁶ Paragraph 78

³⁷ Paragraph 56

³⁸ Paragraph 63

³⁹ Paragraph 65

3.45 The draft regulations apply Companies Act 1985 provisions as they will be amended by the DTI's proposals in their consultation on implementation of the Modernisation Directive and the IAS regulation.⁴⁰

Provisions not to be Applied

3.46 As syndicates are not able to issue debentures there is no reason to require them to give details of the issues of any debentures.⁴¹

3.47 Syndicates do not own land so information relating to interest in land will not be required.⁴²

3.48 Syndicates do not have shares so they will not need to disclose loans in relation to their purchase.⁴³ Nor do syndicates need to make disclosures in relation to corporation tax.⁴⁴ Preliminary expenses, the expenses of, and commission on, any issue of shares or debentures and the costs of research are not relevant for inclusion as balance sheet items for syndicates.⁴⁵

3.49 We have not required syndicates to disclose in the notes to their accounts the amount of any interest or charges on bank loans, overdrafts and loans of any other kind made to the syndicate⁴⁶ because we do not believe it is relevant.

Q 13. Do you agree with our approach to implementation in these areas?

⁴⁰ "Modernisation of Accounting Directives/IAS Infrastructure" 25 March 2004, URN 04/733. Available at www.dti.gov.uk/consultations or www.hm-treasury.x.gsi.gov.uk/consultations. Consultation closed 2 July 2004

⁴¹ Paragraph 61

⁴² Paragraph 64

⁴³ Paragraph 72(2)

⁴⁴ Paragraph 74

⁴⁵ Paragraph 2(2)

⁴⁶ Paragraph 73

4

GLOBAL ACCOUNTS

INTRODUCTION

4.1 This chapter summarises our approach to the implementation of the IAD for the aggregation of Lloyd's syndicate accounts.

GLOBAL ACCOUNTS

4.2 The IAD as amended will still require Lloyd's to prepare aggregate accounts. For insurance undertakings with subsidiaries, Article 65 of the IAD requires them to produce consolidated accounts but in recognition of the different nature of Lloyd's as a market rather than a group of undertakings, Article 4 of the IAD retains the requirement of aggregate accounts for Lloyd's. These aggregate accounts are defined as the cumulation of all syndicate accounts. The statutory global accounts are intended to show the aggregate results of the members of Lloyd's taken together and the aggregate of all syndicates' assets and liabilities.

4.3 Currently, Lloyd's are required to prepare a global account in respect of each financial year by regulation 4 of the IAD (Miscellaneous Insurance Undertakings) Regulations 1993 and by the FSA's Lloyd's Sourcebook (LLD). This global account amalgamates all syndicate accounts for that year.

4.4 The purpose of the Lloyd's global accounts is to provide information about the performance of the Lloyd's market as a whole and give comparable financial information to other areas of the insurance industry.

4.5 In the last couple of years, the Lloyd's global results have included a Pro Forma Annual Accounting Statement (PFAAS). This is intended to present a technical and a non-technical account and a balance sheet on a basis generally comparable with other consolidated accounts of insurance groups in the industry. Consequently, the legislative effect of the IAD being applicable to the Global accounts was something Lloyd's were keen to see take effect.

Implementation

4.6 It is our proposal to revoke regulation 4 the Miscellaneous Insurance Undertakings Regulations 1993 and replace it by Part 3 of the draft regulations at Annex B. These regulations will impose the duty on the Council of Lloyd's to prepare aggregate accounts, have those accounts audited and prepare an annual report. As the provisions of the IAD apply to the aggregate accounts as well as to the syndicate accounts, we have taken the same approach of applying Schedule 9A (with a few exceptions) to the aggregate accounts. The exceptions are the same as for syndicate accounts because the provisions need to apply consistently for the aggregation to work.

Global Audit Regime

4.7 Currently, under instructions issued by the Council of Lloyd's, the Corporation auditors carry out a review of the global accounts and produce a report providing an opinion as to whether the global accounts have been properly prepared in accordance with the requirements of the LLD.

4.8 Going forward, the Lloyd's auditor will not be required by the IAD to give an opinion as to whether the global accounts give a true and fair view, in contrast with the position for syndicate accounts. Therefore, it is necessary to determine on what basis the opinion should be. We propose that the auditors' opinion should have the following three requirements:

- An opinion as to whether the aggregate accounts comply with the requirements of the regulations;
- An opinion as to whether the aggregate accounts are in agreement with the syndicate accounts cumulated to prepare them; and
- An obligation to report on whether the annual report of the Council of Lloyd's is consistent with the aggregate accounts.

Q 14. Do you agree with our approach to the Global accounts?

Q 15. Do you agree with our proposed requirements for the auditors' opinion?

5

LIST OF QUESTIONS

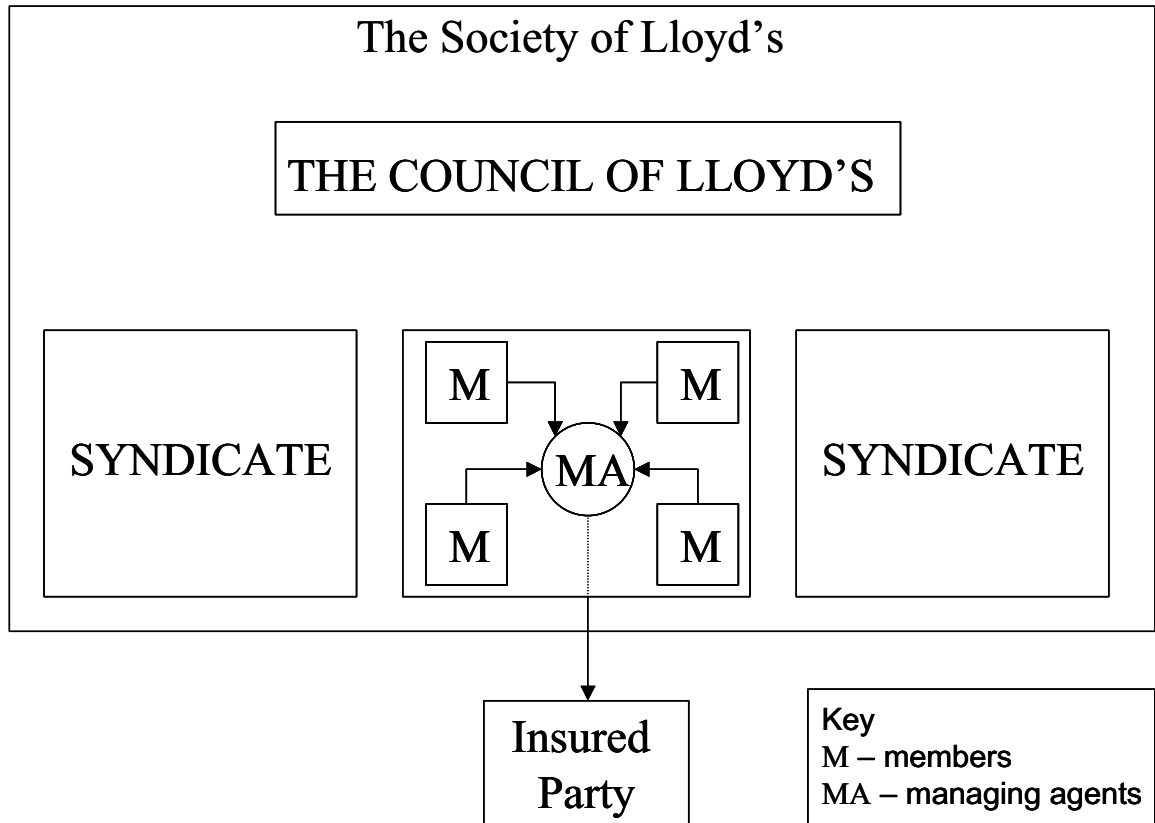
- Q 1. The details of our proposed approach to implementation are discussed in the rest of the document. Are there any comments about our general approach of using existing provisions wherever possible?
- Q 2. Should emoluments and other benefits of directors of Managing Agents be disclosed in the syndicate accounts?
- Q 3. Should the emoluments of anyone else be disclosed?
- Q 4. Should the duties of Managing Agents be as we describe?
- Q 5. Should the FSA receive and scrutinise the accounts?
- Q 6. Should sanctions be imposed upon the Directors of Managing Agents?
- Q 7. Should funds at Lloyd's be reflected somewhere in the reported syndicate accounts?
- Q 8. How should funds at Lloyd's be reflected?
- Q 9. Do you agree with our approach to the layout and contents of the Balance Sheet?
- Q 10. Do you think a breakdown of figures by underwriting year of account should be included in the notes, reports or review of the accounts in some way?
- Q 11. In what way do you think a breakdown of figures by underwriting year of account should be reported?
- Q 12. Do you agree with our approach to the layout and contents of the Profit and Loss account?
- Q 13. Do you agree with our approach to implementation of additional requirements that are not included in the Directives?
- Q 14. Do you agree with our approach to the Global accounts?
- Q 15. Do you agree with our proposed requirements for the auditors' opinion?

A

THE STRUCTURE OF LLOYD'S

BACKGROUND

THE STRUCTURE OF LLOYD'S



The Society and the Council

5.1 Lloyd's is an insurance marketplace as opposed to an insurance company. The insurance business transacted ranges from standard personal lines insurance to bespoke insurance of specialised, one-off risks. The Society of Lloyd's is incorporated as Lloyd's under various private Acts of Parliament, known as Lloyd's Acts 1871 to 1982. The objects of the Society include "the carrying on by Members of the Society of the business of insurance of every description including guarantee business". The objectives of the Society do not include the carrying on of insurance business by the Society. The Society is not authorised to underwrite insurance business. ¹

5.2 The Council of Lloyd's (established by the Lloyd's Act 1982) is the Society's governing body. It has control over the management and regulation of the affairs of the Society of Lloyd's. The Council has the power to manage and supervise the affairs of the Society, to regulate and direct the business of insurance at Lloyd's and exercise all the

¹ See section 4 Lloyds Act 1911

powers of the Society. The Council also has power to make such bye-laws as it thinks fit to further the objectives of the Society.

Members and Syndicates

5.3 Individuals (resident in a variety of countries), bodies corporate (including those incorporated overseas) and Scottish Limited Partnerships (SLPs) are eligible for membership of the Society. Although individual members still represent the majority in number of Lloyd's members, corporate members provide the major part of the market's capacity.

5.4 Members underwrite the insurance business at Lloyd's as a member of one or more syndicates. Syndicates have no legal personality and are merely the vehicle through which the members underwrite insurance risk. Syndicates generally have a number of members although there are some single corporate member syndicates operating in the Lloyd's market. Although insurers combine into syndicates the liability of each insurer is confined to the share of the liability it has accepted under policies underwritten on its behalf. Each member writes insurance through a syndicate on a several basis and does not have joint liability with any other member of a syndicate for risks underwritten through that syndicate; there is no mutualisation of liability within or between syndicates.

5.5 Each Lloyd's syndicate is an annual venture. The year during which it writes business is described as an 'underwriting year' or a 'year of account'. Members will have no liability for business underwritten by the same syndicate in previous years of account unless they were members in those years, or unless they have reinsured the members of that syndicate for the previous years.

The operation of syndicates

5.6 Members are not permitted to underwrite insurance other than through a managing agent. Members may not interfere with the exercise of the management and control of their insurance business. A syndicate may have one or many members who are severally liable for their own proportion of the business of the syndicate.

5.7 A managing agent may manage several syndicates, which may have different membership. The managing agent is responsible for, amongst other things:

- determining the underwriting policy;
- accepting the underwriting risk;
- determining the premium for reinsurance to close (RITC), whereby the liabilities of the members of a syndicate for one year of account are usually reinsured to close by the members of the same, or another, syndicate for a later year of account; and
- agreeing and settling all claims against the syndicate.

5.8 Technically each syndicate is an annual venture through which members participate for a specific year of account. A member of a syndicate for a particular year of account is entitled to continue to participate in that syndicate for succeeding years of account. The same syndicate number will continue to be used but the membership and proportions of business accepted by the members may differ in each year of account and the operations for each year of account are distinct commercial ventures.

5.9 Years of account at present stay open for three years. At the end of that period it is usual for residual liabilities, as well as liabilities incurred but not reported, to be transferred to subsequent years of account by the process known as Reinsurance to Close (RITC). RITC is usually provided by members of the same or another syndicate for a later year of account in exchange for a reinsurance premium.

5.10 The purpose of RITC is to transfer residual liability and appropriate assets, in the form of a premium, from one year of account (the closing year) to usually the next open year of account (the accepting year).

5.11 Under the RITC process, underwriting members comprising a syndicate agree to indemnify the underwriting names of that or another syndicate for an earlier year of account against all known and unknown liabilities arising out of insurance business underwritten through that syndicate and allocated to the closed year.

5.12 As syndicate membership may change from year to year, it is important that syndicate expenses and other items which may affect more than one year of account (including RITC premiums) are allocated equitably between the members of the syndicate affected. One of Lloyd's core principles is that agents should conduct the affairs of the members for which it acts in a way that does not unfairly prejudice the interests of any such members. The Society monitors compliance with this principle.

2004 No.

INSURANCE

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004

<i>Made</i>	- - - -	2004
<i>Laid before Parliament</i>		2004
<i>Coming into force</i>	- -	2004

The Treasury, being a department designated ⁽⁴⁷⁾ for the purposes of section 2(2) of the European Communities Act 1972 ⁽⁴⁸⁾ in relation to measures regulating the conduct of insurance business at Lloyd's of London, in exercise of the powers conferred by that section hereby makes the following Regulations:

PART 1

General

Citation, commencement and extent

1. These Regulations may be cited as the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 and shall come into force on 31st December 2004.

Interpretation

2.—(1) In these Regulations —

“the 1985 Act” means the Companies Act 1985 ⁽⁴⁹⁾;

“the Authority” means the Financial Services Authority;

“financial year” means each period of 12 months beginning with 1st January;

“managing agent” means a person who is permitted by the Council of Lloyd's, in the conduct of his business as an underwriting agent, to perform, for a member of Lloyd's, one or more of the following functions –

(a) underwriting contracts of insurance at Lloyd's;

⁽⁴⁷⁾ The Transfer of Functions (Insurance) Order 1997 S.I. 1997/2781.

⁽⁴⁸⁾ 1972 c. 68

⁽⁴⁹⁾ 1985 c. 6

- (b) reinsuring such contracts in whole or in part;
- (c) paying claims on such contracts;

“syndicate” means one or more persons, to whom a particular syndicate number has been assigned by or under the authority of the Council of Lloyd’s, carrying out or effecting contracts of insurance written at Lloyd’s.

- (2) Any reference in these Regulations to the accounts required by or prepared under regulation 3, are references to the annual accounts, the annual report and the auditors’ report required by or prepared under paragraph (2) of that regulation.

and other expressions shall have the meanings ascribed to them by the 1985 Act.

PART 2

Syndicate accounts

Preparation of syndicate accounts

3.—(1) Managing agents must prepare or cause to be prepared the accounts and reports required by paragraph (2) below, in respect of

- (a) each syndicate that they manage on 31st December; and
- (b) any syndicate that they were the last managing agent to manage during the preceding year and which has no managing agent on 31st December.
- (2) Managing agents must, for the financial year preceding 31st December, in respect of each syndicate which paragraph (1) above requires them to prepare accounts and reports for –
 - (a) prepare the like annual accounts and annual report; and
 - (b) cause to be prepared such an auditors’ report

as would be required under the provisions mentioned in paragraph (4) below if the syndicate were an insurance company formed and registered under the 1985 Act.

- (3) The accounts required by this regulation –
 - (a) must be prepared within a period of 3 months beginning immediately after the end of the syndicate’s financial year;
 - (b) must state that they are prepared under this regulation; and
 - (c) must comply with such of the requirements of the provisions mentioned in paragraph (4) below as relate to the contents of the required accounts or reports, subject to the provisions of Schedule 1 to these Regulations.
- (4) The provisions referred to in paragraphs (2) and (3) above are the following provisions of Part VII of the 1985 Act, namely –
 - (a) sections 226(1) and (2)(a), 226A, 231, 232, 233, 234, 234A, 235, 236, 237, 240, 242B, 255;⁽⁵⁰⁾
 - (b) paragraphs 11 and 12 of Schedule 5;
 - (c) Paragraph 6 of Schedule 7;
 - (d) Schedule 9A other than paragraphs 10(2), 61, 64, 65, 72(2), 73 and, in paragraph 2(2) the words from “but the following” to the end and Part 2 of that Schedule.
- (5) For the purposes of those provisions as applied to accounts prepared under this regulation, these Regulations shall be regarded as part of the requirements of the 1985 Act.

⁽⁵⁰⁾ Some of the sections referred to here are going to be amended by The Companies Act 1985 (Miscellaneous Accounting and Reporting Amendments) Regulations 2004 and section 226A will be inserted by those regulations.

- (6) Part II of the Companies Act 1989 (eligibility for appointment as auditors) shall apply to auditors appointed for the purposes of this regulation subject to any necessary modifications to take account of the fact that the syndicate is unincorporated.
- (7) The Schedule to these Regulations shall have effect for the purpose of modifying the provisions of the 1985 Act in their application to syndicates.

Accounts and reports to be sent to syndicate members, the Council and the Authority

4.—(1) A copy of the accounts prepared under regulation 3 for a syndicate must be sent to every member of Lloyd's who participates in that syndicate and the Council of Lloyd's, [within 21 days of the managing agent approving and signing the syndicate's accounts in accordance with section 233 of the 1985 Act (as applied and modified by these Regulations)] OR [within 3 months of the end of the financial year].

- (2) A copy of the accounts prepared under regulation 3 for a syndicate must be sent to the Financial Services Authority within a period of 6 months beginning immediately after the end of the syndicate's financial year.
- (3) References in this regulation to sending to any person copies of the accounts and reports, include references to using electronic communications for sending copies of those documents to such address as may for the time being be notified to the managing agent by that person for that purpose.

Publication of syndicate accounts

5. Where a managing agent has sent accounts prepared under regulation 3 in respect of a Lloyd's syndicate to the Council of Lloyd's under regulation 4, the Council must —

- (a) make available those accounts and reports for inspection by any person, without charge and during business hours at the Society of Lloyd's registered office for a period of three years from the date of signature of each document;
- (b) supply to any person upon request a copy of those accounts and reports (or such part of those accounts and reports as may be requested) at a price not exceeding the administrative cost of making the copy, for a period of three years from the date of signature of each document.

Penalties for non-compliance

6.—(1) If the managing agent of a Lloyd's syndicate fails to comply with paragraph (1) of regulation 3, within the period referred to in paragraph (3) of that regulation, the managing agent and every person who was a director or partner of the managing agent immediately before the end of that period is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.

- (2) If accounts and reports which are made available for inspection or supplied under regulations 4 and 5, do not comply with the requirements of regulation 3, the managing agent of the Lloyd's syndicate and every person who was a director or partner of the managing agent at the time when the accounts were first made available for inspection or supplied is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (3) If a managing agent fails to comply with regulation 4(1), it and every person who at the time the failure takes place, is a director or partner of it is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (4) If a managing agent fails to comply with regulation 4(2), it and every person who, at the time the failure takes place, is a director or partner of it is guilty of an offence and liable on summary conviction to a fine not exceeding level 5 on the standard scale.
- (5) It is a defence for a person charged with an offence under this regulation to show that it took all reasonable steps for securing that the requirements in question would be complied with.
- (6) Section 731 of the 1985 Act shall apply to any offence under this regulation.

PART 3

Aggregate accounts

Preparation of aggregate accounts by Council of Lloyd's

7.—(1) The members of the Council of Lloyd's must prepare aggregate accounts in respect of each financial year by cumulating all syndicate accounts for that year. The aggregate accounts shall consist of –

- (a) an aggregate balance sheet as at the last day of the year; and
- (b) an aggregate profit and loss account.

Those accounts are referred to in these Regulations as the “aggregate accounts”.

(2) The aggregate accounts –

- (a) shall be prepared within the period of 6 months beginning immediately after the end of the financial year; and
- (b) shall state that they are prepared under these Regulations.

(3) The aggregate accounts shall comply with the provisions of the 1985 Act set out in paragraph (5) below as to the form and content of the aggregate balance sheet and aggregate profit and loss account, and additional information to be provided by way of notes to the accounts.

(4) The provisions referred to in paragraph (4) above are the following –

Schedule 9A to the 1985 Act other than paragraphs 10(2), 61, 64, 65, 72(2), 73 and, in paragraph 2(2) the words from “but the following” to the end and Part 2 of that Schedule.

Approval and signing of aggregate accounts

8.—(1) The aggregate accounts must be approved by the Council of Lloyd's and signed on behalf of the Council by a member of the Council.

- (2) The signature shall be on the aggregate balance sheet.
- (3) Every copy of the balance sheet which is circulated, published or issued shall state the name of the person who signed the balance sheet on behalf of the Council.
- (4) The copy of the aggregate balance sheet which is delivered to the authority shall be signed on behalf of the Council by a member of the Council.

Preparation of annual report by the Council of Lloyd's

9.—(1) The members of the Council of Lloyd's must prepare an annual report on the insurance business carried on by the members of Lloyd's containing –

- (a) a fair review of the insurance business carried on by the members of Lloyd's during the financial year, and of the position of the Lloyd's market at the end of it, consisting of a balanced and comprehensive analysis of the development and performance of the business of the members of Lloyd's; and
 - (b) a description of the principal risks and uncertainties facing the Lloyd's market.
- (2) The business review in the Council of Lloyd's annual report must, to the extent necessary for an understanding of the development, performance or position of the insurance business of the members of Lloyd's include –
- (a) analysis using financial key performance indicators; and
 - (b) where appropriate, analysis using other key performance indicators.
- (3) The review must, where appropriate, include references to and additional explanations of amounts included in the aggregate accounts.
- (4) In this regulation “key performance indicators” means factors by reference to which the development, performance or position of the insurance business of the members of Lloyd's, can be measured most effectively.

Approval and signing of annual report

10.—(1) The annual report prepared under regulation 9 above shall be approved by the Council of Lloyd's and signed on behalf of the Council by a member of the Council.

- (2) Every copy of the annual report which is circulated, published or issued, shall state the name of the person who signed it on behalf of the Council.
- (3) The copy of the annual report which is delivered to the authority shall be signed on behalf of the Council by a member of the Council.

Auditors' report

11.—(1) The members of the Council of Lloyd's must obtain an auditors' report on the aggregate accounts.

- (2) The auditor's report shall include –
 - (a) an introduction identifying the aggregate accounts that are the subject of the statutory audit and the financial reporting framework that has been applied in their preparation;
 - (b) a description of the scope of the audit identifying the auditing standards in accordance with which the audit was conducted;
 - (c) the report shall state clearly whether in the auditors' opinion the aggregate accounts have been properly prepared in accordance with the requirements of these Regulations.
- (3) The auditors' report –
 - (a) shall be either unqualified or qualified; and
 - (b) shall include a reference to any matters to which the auditors wish to draw attention by way of emphasis without qualifying the report.
- (4) The auditors shall, in their report, state whether the annual report of the Council of Lloyd's, in the auditor's opinion –
 - (a) is consistent with the aggregate accounts for the same financial year; and
 - (b) has been prepared in accordance with these Regulations.

Signature of auditors' report

12.—(1) The auditors' report shall state the names of the auditors and be signed and dated by them.

- (2) Every copy of the auditors' report which is circulated, published or issued shall state the names of the auditors.
- (3) The copy of the auditors' report which is delivered to the Authority shall state the names of the auditors and be signed and dated by them.
- (4) References in this regulation to signature by the auditors are, where the office of auditor is held by a body corporate or partnership, to signature in the name of the body corporate or partnership by a person authorised to sign on its behalf.

Appointment of and duties of auditors

13.—(1) Part II of the Companies Act 1989 (eligibility for appointment as auditors) shall apply to auditors appointed by the Council of Lloyd's to audit the aggregate accounts.

- (2) The auditors of the aggregate accounts shall, in preparing their report, carry out such investigations as will enable them to form an opinion as to whether the aggregate accounts are in agreement/consistent with the syndicate accounts which have been cumulated to prepare them.
- (3) If the auditors of the aggregate accounts are of the opinion that the aggregate accounts are not consistent with the syndicate accounts which have been cumulated to prepare them the auditors shall state that fact in their report.

- (4) If the auditors of the aggregate accounts fail to obtain all the information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of their audit, they shall state that fact in their report.

Aggregate accounts and annual report of Council to be delivered to the Authority and published

14.—(1) The Council of Lloyd's must deliver to the Authority a copy of the aggregate accounts and its annual report on each financial year within a period of 6 months from the end of that year.

- (2) The Council of Lloyd's must –
- (a) make available the latest aggregate accounts and its latest annual report prepared under regulations 7 and 9 above for inspection by any person, without charge and during business hours, at the Council's office in London; and
 - (b) supply to any person upon request a copy of those accounts or that report (or such part of them as may be requested) at a price not exceeding the administrative cost of making the copy.

PART 4

Regulation by the Financial Services Authority

Functions of Financial Services Authority

15.—(1) The Authority has responsibility for administering the system of regulation of Lloyd's syndicates and the Council of Lloyd's provided for by these Regulations.

- (2) Proceedings for an offence under these Regulations may be instituted only –
- (a) by the Authority or the Secretary of State; or
 - (b) by or with the consent of the Director of Public Prosecutions.
- (3) In exercising its power to institute proceedings for an offence under these Regulations, the Authority must comply with any conditions or restrictions imposed in writing by the Treasury.
- (4) The Authority may increase any fee which it charges managing agents under the Financial Services and Markets Act 2000 ⁽⁵¹⁾ to take account of the expenses incurred in carrying out its functions under these Regulations.

PART 5

Transitional and Consequential Provisions

Transitional provisions

16.—(1) The managing agent of a syndicate need not prepare accounts in accordance with regulation 3 with respect to a financial year of the syndicate commencing before 31st December 2004.

- (2) Where advantage is taken of paragraph (1), regulation 6 shall not apply to the managing agent.
- (3) The members of the Council of Lloyd's need not –
- (a) prepare aggregate accounts in accordance with regulation 7;
 - (b) prepare an annual report in accordance with regulation 9; and
 - (c) obtain an auditors' report in accordance with regulation 11.

⁽⁵¹⁾ 2000 c. 8.

Consequential provisions

17.—(1) Regulations 4, 5(2), 6(1)(b), 6(2)(b) and 6(3)(b) of the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993 ⁽⁵²⁾ are hereby revoked.

(2) In regulations 6(1), 6(2) and 6(3) of those regulations the following words are deleted –
“or (as the case may be) a member of the Council of Lloyd’s”.

Address

Name

Date

Two Lords Commissioner of HM Treasury

⁽⁵²⁾ S.I. 3245/1993.

SCHEDULE 1

Modification and adaptations of Part VII of the Companies Act 1985 for syndicate accounts

Regulation 3

1. The accounts prepared under regulation 3 shall comply with the provisions of the 1985 Act set out in paragraph (3) of that regulation subject to any necessary modifications to take account of the fact that syndicates are unincorporated.
2. Where any of the provisions of the 1985 Act set out in regulation 3(3) impose a duty on the directors of a company, that provision shall, in the case of a syndicate, impose the same duty upon the managing agent of the syndicate.
3. Section 226 shall be modified in its application to syndicates as follows –
 - (a) In subsection 226(2) for the word “may” there shall be substituted “must”.
 - (b) At the end of subsection 226(2)(a) the word “or” is omitted.
4. Section 232 of the 1985 Act shall be modified in its application to syndicates as follows –
 - (a) For subsection (1) there shall be substituted the following –

“(1) The information specified in subsection (2) shall be given in notes to the syndicate’s annual accounts.”
 - (b) For subsection (2) there shall be substituted the following –

“(2) The information referred to in subsection (1) is –

 - (a) The aggregate amount charged to a syndicate by its managing agent in respect of emoluments paid to the managing agents directors, active underwriter and (where applicable) run-off manager of the syndicate in the last financial year;
 - (b) The specific amount charged to a syndicate by its managing agent in respect of emoluments paid to the syndicate’s active underwriter and (where applicable) its run-off manager in the last financial year;
 - (c) For subsection (3) there shall be substituted the following –

“(3) In this section “emoluments” -

 - (a) includes salaries, fees and bonuses, sums paid by way of expenses allowance (so far as they are chargeable to United Kingdom income tax) and, subject to paragraph (b), the estimated money value of any other benefits received by him otherwise than in cash; but
 - (b) does not include any of the following, namely –
 - (i) the value of any share options granted or the amount of any gains made on the exercise of any such options;
 - (ii) any contributions paid, or treated as paid, in respect of him under any pension scheme or any benefits to which he is entitled under any such scheme; or
 - (iii) any money or other assets paid, received or receivable under any long term incentive scheme.”

(d) Subsection (4) is deleted.

5. Section 233 of the 1985 Act shall be modified in its application to syndicates as follows –

For subsection (1) there shall be substituted the following –

“(1) A syndicate’s accounts shall be approved and signed by the syndicate’s managing agent and where the managing agent is a body corporate or a partnership the accounts shall be signed by a director or partner of the managing agent, authorised to sign on its behalf.”;

6. Section 234 of the 1985 Act shall be modified in its application to Lloyd’s syndicates as follows –

In subsection (2) the words “state the names of the persons who, at any time during the financial year were directors of the company, and” shall be omitted.

7. Section 234A of the 1985 Act shall be modified in its application to Lloyd’s syndicates as follows –

For subsection (1) there shall be substituted the following –

“(1) The directors’ report shall be approved and signed by the syndicate’s managing agent and where the managing agent is a body corporate or a partnership, the report shall be signed by a director or partner of the managing agent, authorised to sign on its behalf.”.

8. Section 240 of the 1985 Act shall be modified in its application to Lloyd’s syndicates as follows –

In subsection (5), for “as required to be delivered to the registrar under section 242” substitute “as required to be sent to the authority under regulation 4(2) of the Insurance Accounts Directive (Lloyd’s Syndicate and Aggregate Accounts) Regulations 2004”.

IMPLEMENTATION OF THE EU DIRECTIVE 2003/51/EC FOR LLOYD'S

(AMENDING DIRECTIVE 1991/674/EEC INSURANCE UNDERTAKING – ANNUAL AND CONSOLIDATED ACCOUNTS)

PURPOSE AND INTENDED EFFECT OF MEASURE

5.13 The Insurance Undertaking – Annual and Consolidated Accounts Directive (the IAD) is concerned with the presentation and content of insurance companies' annual accounts and annual reports (including consolidated accounts)⁵³. The Directive creates a unified accounting approach across Europe for insurance undertakings within its scope. Originally the IAD applied to Lloyd's through an annex outlining alternative specific provisions for Lloyd's accounting.

5.14 The IAD has now been amended by the Modernisation of Accounts Directive (Modernisation Directive)⁵⁴. The effect of this measure is that, in line with Lloyd's wishes, Lloyd's will now have to comply with the accounting provisions of the IAD in the same way as other insurance undertakings. The Modernisation Directive is designed to bring European accounting requirements into line with modern accounting practices and it amends several accounting directives to achieve this. The Modernisation Directive removes conflicts between the Accounting Directives and the International Accounting Standards which were in existence at the time it was drawn up. It also ensures that optional accounting treatments available under International Accounting Standards are available to undertakings which prepare their accounts under the Accounting Directives.

POLICY OPTIONS

5.15 The IAD was previously implemented for insurance companies through Schedule 9A of the Companies Act 1985. For non-company insurance undertakings (Lloyd's and Lloyd's syndicates are not companies) the Directive was implemented through the Miscellaneous Insurance Undertakings Regulations 1993 which made certain sections of Schedule 9A applicable⁵⁵. We have proposed to implement the Directive by applying particular section of Schedule 9A with modifications for Lloyd's specific circumstances.

5.16 We believe there are three main implementation options available:

- Option 1: Do nothing;
- Option 2: Do the minimum necessary to meet the requirements of the Directive; or

⁵³ Insurance Accounts Directive (1991/674/EEC)

⁵⁴ Modernisation of Accounts Directive (2003/51/EC)

⁵⁵ Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 1993. These implement parts of Schedule 9A applicable to non-company insurance undertakings.

- Option 3: Implement the Directive consistently with the accounting requirements for other UK insurers as far as possible.

COSTS

Option 1:

5.17 A direct and immediate cost of doing nothing will be infraction fines levied by the European Court of Justice for each day that the Directive is not implemented for Lloyd's.

Option 2:

5.18 There should be no or very little direct and immediate cost to adopting this option. Going forward, as now, Managing Agents will need to prepare the accounts with the help of accountants and an auditor's opinion will be required. Those currently involved with the accounts will need to familiarise themselves with the new requirements.

5.19 Costs for compliance with the provisions of this Directive will form part of the administrative expenditure of Managing Agents, as they are responsible for the compilation and production of the accounts. Consequently, there is a possibility these costs may be passed onto the members of the syndicates.

5.20 Managing Agents are already required to compile and publish accounts so we foresee no significant difference in costs in this regard. Extra work may be necessary by audit firms, particularly during the first few years whilst Lloyd's adapts to comply with the requirements of the new reporting regime. However, the market received notice of this change from the Society in November 2003 and should have had time to prepare. This may be more time consuming than for option 3 because for those involved with the accounts (particularly in the case of accountants and actuaries), the accounting regime will differ from that of other insurance undertakings with which they are already familiar. It is not possible to quantify this cost.

5.21 The implementation of the Directive does allow for sanctions against Managing Agents for non-compliance which could lead to possible increased financial penalties with failure to comply.

Option 3:

5.22 The costs should be similar to those of option 2. The costs may be less than for option 2 because those involved with the accounts (particularly accountants and actuaries) will be applying a regime to Lloyd's which they already use to draw up other accounts.

BENEFITS

Option 1

5.23 Lloyd's accounts will continue to be prepared on a different basis to the rest of the insurance industry. Lloyd's wants its accounts to be more comparable with other insurers and could require additional accounts to be prepared on a more comparable basis. There are therefore few, if any, benefits to not implementing the Directive.

Option 2

5.24 The move to annual accounting should bring the Lloyd's market on to a comparable accounting basis with the rest of the insurance industry than it currently is enabling Lloyd's to promote its business better and generally be more comparable with other insurers. The comparability would not, however, be as great as it could be because there are slightly more disclosure requirements placed on UK firms than required by the IAD.

5.25 In addition, annual distribution and cash calls will give an earlier indication of the performance of a syndicate and possibly appeal to market participants. The obligation upon Lloyd's to prepare accounts based upon the principles discussed should increase the confidence of market participants and enhance comparability with other insurers whilst providing for good accountancy practice.

Option 3

5.26 The benefits of this option are the same as for option two except this option provides the greatest compatibility and comparability between the accounts of Lloyd's and other insurers.

BUSINESS SECTORS AFFECTED

5.27 The main business sector that will be affected is the Lloyd's market and those who are involved with it: members (particularly corporate); managing agents; accountants and auditors. The accounts for syndicates through which corporate members participate will now look similar to that members' company accounts, with the accounts of a syndicate with only one member that is corporate looking nearly identical to that member's company accounts. Managing agents will be preparing accounts on a different basis to that which they currently use. Generally, the obligations placed upon them with regards to the accounts will be very similar to as they are now, only with monitoring and enforcement being conducted by a different body. Criminal liability for the directors of Managing Agents for syndicate accounts will be different to the existing arrangements but mirrors the liability those directors have as to the Managing Agent's accounts.

5.28 The implementation of the IAD will only affect charities, voluntary organisations or small businesses to the extent where they may be members of a syndicate.

COMPETITION ASSESSMENT

5.29 The IAD requirements will apply equally to all market participants, whether new entrants or established firms. It is not expected that the IAD will give rise to higher costs for new firms as opposed to established firms, nor should it affect the structure of the market. We foresee no change to the current level of competition within the market and the proposed changes should help Lloyd's accounts to be considered on a comparable basis with those undertakings reporting in the rest of the insurance sector.

ENFORCEMENT AND SANCTIONS

5.30 We believe there are approximately 66 syndicate accounts. The FSA will accept, file accounts, scrutinise accounts and enforce the sanctions. This is an area of increased costs for the FSA, as the Society of Lloyd's currently fulfils this role.

CONSULTATION

5.31 While developing the proposals for implementing the Directive in respect of Lloyd's, HM Treasury has consulted closely with Lloyd's.

5.32 The Treasury will consult on its proposals and this partial regulatory impact assessment for twelve weeks. The consultation paper was issued on [23 July 2004] and the consultation will close on [15 October 2004].

SUMMARY AND RECOMMENDATION

5.33 Option 3 is the preferable approach. It provides the greatest compatibility and comparability between the accounts of Lloyd's and other insurers.

ISBN 1-84532-038-7



9 781845 320386 >