The Legislative Reform (Lloyd's) Order 2008: explanatory document

July 2008



HM TREASURY



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INTRODUCTION

1.1 This Explanatory Document is laid before Parliament in accordance with section 14(1) of the Legislative and Regulatory Reform Act 2006 ("the 2006 Act") together with a draft of the Legislative Reform (Lloyd's) Order 2008 ("the draft Order") which Treasury Ministers propose to make under section 1 of that Act.

1.2 The purpose of the draft Order is to amend Lloyd's Act 1982, in order to modernise the governance arrangements at Lloyd's and remove unnecessary restrictions on how Lloyd's organises its affairs. This will complement the market-related reforms that Lloyd's is already pursuing, which the Government supports, and which are geared to maintaining the competitiveness of Lloyd's in the global marketplace.

1.3 The Explanatory Document is arranged as follows:

- Chapter 2 sets out the background and provides an overview of the proposals.
- Chapter 3 discusses the Treasury consultation, and sets out the Minister's recommended Parliamentary procedure and statements as regards compatibility with human rights and EU membership obligations.
- Chapters 4 and 5 provide a full analysis of the proposed reforms, following the order in which they were presented for public consultation in the Spring. The commentary includes details of respondents' views on each proposed reform and the Government's response to these.
- Separately, Chapter 6 reviews the additional reforms that respondents sought to have added to the LRO, and provides the Government's response to these requests.

2 Background to the Order

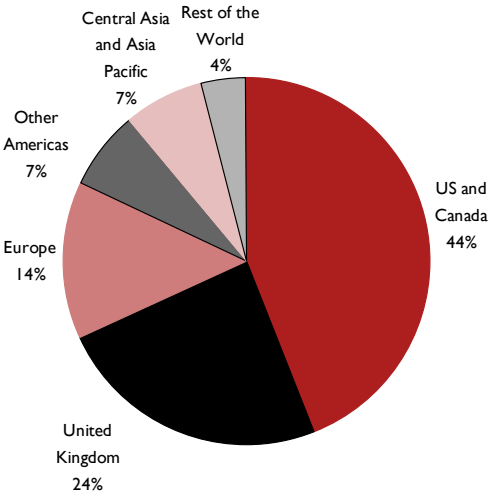
Lloyd's market in 2008

2.1 Lloyd's is one of the world's largest markets for wholesale insurance and a leading part of the London insurance market. In 2007, Lloyd's members underwrote gross written premiums of £16.3bn and achieved a profit before tax of £3.8bn.

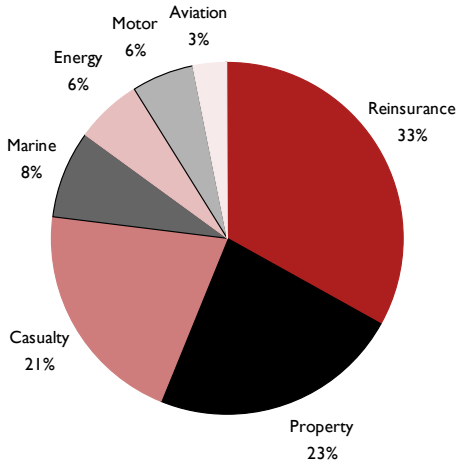
2.2 Lloyd's is licensed to underwrite business in 79 territories and can accept risks from over 200 countries and territories in accordance with local laws and regulations. Lloyd's business profile is set out below. The main business sectors – non-marine (property and casualty), marine, energy and aviation – are typically characterised by complexity, large exposure levels and a high severity/low frequency risk profile.

Box 1.1: Lloyd's business profile 2007

Geographical split



Class of business split

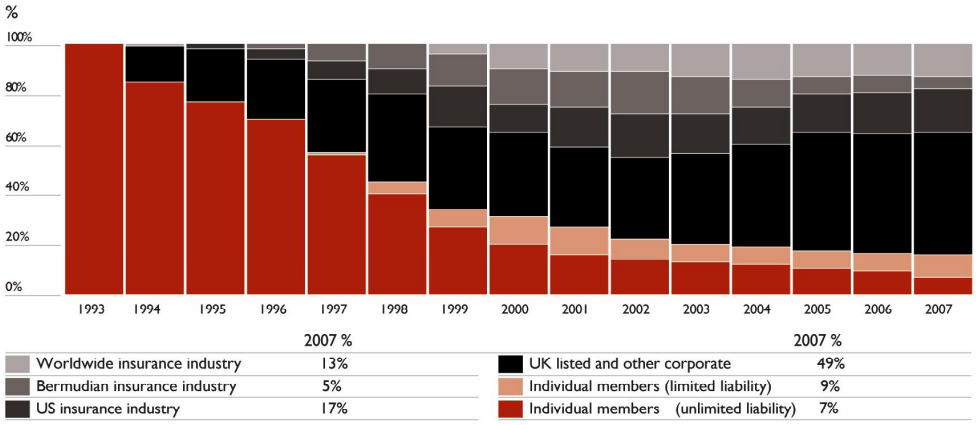


Source: Lloyd's 2007 Annual Report

Underwriting and membership

2.3 Individuals (or Names) have underwritten insurance business as members of Lloyd's since 1688. However, over the last 15 years, the membership has changed as new categories of members have been permitted to join (since 1994 companies, since 1997 Scottish Limited Partnerships (SLPs) and since 2007, Limited Liability Partnerships (LLPs)). Companies, SLPs and LLPs are generally referred to as corporate members, to distinguish them from individual members. Since 2003, Lloyd's has not admitted new individual members.

Box 2.2: Lloyd's members' sources of capital by type and location

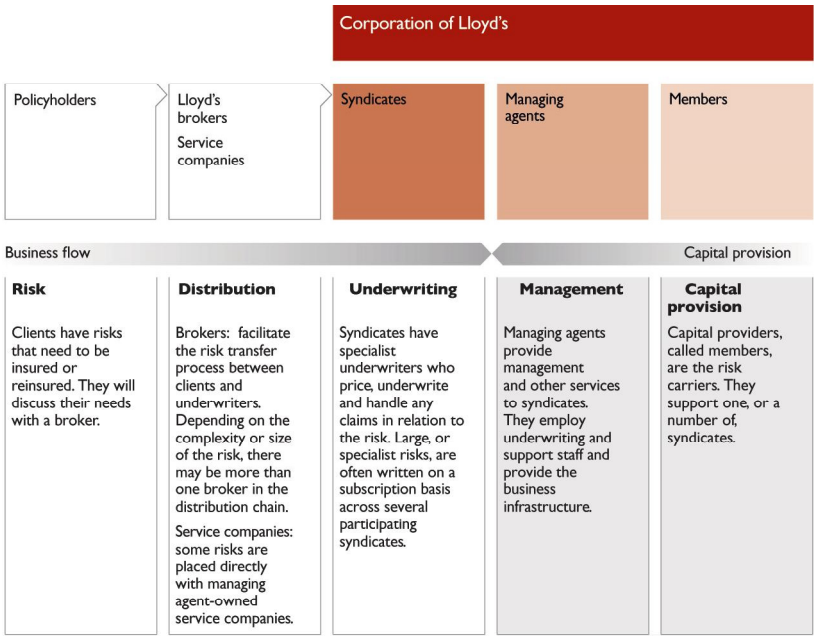


Source: Lloyd's 2007 Annual Report

2.4 Most of Lloyd's business is written on a subscription basis, i.e. where risks are shared between more than one syndicate. Under Lloyd's traditional operating model, underwriting members (the capital providers) join together in syndicates to provide capacity for the underwriting business. Syndicates are annual ventures, which form at the beginning of each underwriting year. Each annual venture is closed once all outstanding and incurred but not reported claims are reinsured into a successor syndicate through the reinsurance to close (RITC) mechanism.

2.5 Syndicates underwrite through agents known as managing agents. Managing agents carry out all underwriting functions on behalf of syndicate members, including entering into contracts of insurance, effecting reinsurance and paying claims on the members' behalf. The business process is illustrated below.

Box 2.3: How Lloyd's works



Source: Lloyd's 2007 Annual Report

2.6 As at end December 2007, there were 46 managing agencies and 72 syndicates operating at Lloyd's, covering between them a wide range of specialty insurance business. At the start of 2008, the number of syndicates had increased to 75.

2.7 Membership of the syndicates is very diverse, and ranges from wholly aligned syndicates (i.e. where the syndicate has only one corporate member, which is directly or indirectly owned by the same firm that owns the managing agent of the syndicate), to syndicates involving a mixture of corporate members or corporates and individuals together. Syndicates also vary considerably in size. For the 2007 year of account, the largest syndicate had the capacity to underwrite £1,094mn of premium, and the smallest, £5mn.

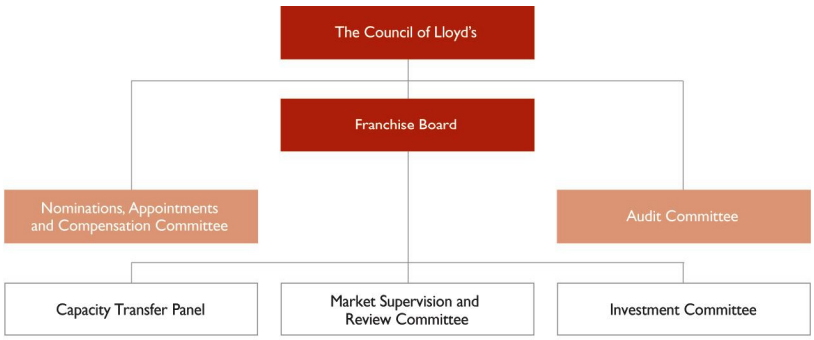
CURRENT GOVERNANCE ARRANGEMENTS

2.8 The Society of Lloyd's is incorporated under Lloyd's Act 1871, but the current statutory framework for governance is set out in Lloyd's Act 1982.

2.9 The 1982 Act provides for a governing Council (under section 3 Lloyd's Act 1982), with powers to regulate and direct the business of insurance at Lloyd's. The Act gives the Council the power to make byelaws and regulations, which have direct application and legal effect on those operating in the market. The Act also sets some specific parameters for the market. These include the framework for the relationship between underwriting members and managing agents, and the rules concerning access to the market.

2.10 As part of its responsibilities, the Council oversees the Lloyd's market, acting through various bodies. Today, the main oversight function is performed by the Franchise Board.

Box 2.4: Principal committees of Lloyd's



Source: Lloyd's 2007 Annual Report

REGULATORY FRAMEWORK

2.11 Since 1 December 2001, the Society of Lloyd's has been regulated and authorised by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000 (FSMA). The FSA is also responsible for the prudential regulation of Lloyd's managing agents, members' agents and UK-based Lloyd's brokers. Lloyd's regulatory responsibilities therefore now sit within the FSA framework, and Lloyd's has

entered into arrangements with the FSA for co-operation on supervision and enforcement.

2.12 In line with this, the Franchise Board sets minimum standards for managing agents and monitors their performance against the syndicates' annual business plans. It also has responsibility for the setting of policy and principles relation to the supervision, regulation and direction of insurance business at Lloyd's which are of general application to the market or any part of the market.

REASON FOR REFORM

2.13 In recent years, Lloyd's has undertaken a major programme of reforms, geared to updating the marketplace and maintaining the global competitiveness of Lloyd's. These were initiated as a result of the Chairman's Strategy Group (which reported in 2002) and have been taken forward as a rolling series of three-year business plans focusing on five core components of Lloyd's business, including performance management and improving the efficiency and effectiveness of Lloyd's operating environment.

2.14 In connection with the latter, Lloyd's is actively involved in the work that is taking place, under the aegis of the Market Reform Group, to improve the operational infrastructure of the London wholesale insurance market, including on placement (contract certainty); accounting and settlement procedures; and claims[1].

2.15 To complement these market-based and market-led initiatives, the Government agreed in June 2007 that it would bring forward proposals to modernise the governance arrangements at Lloyd's, with the aim of updating and streamlining Lloyd's governance procedures, and removing unnecessary restrictions on how Lloyd's organises its affairs.

2.16 The Government believes that the reforms it is proposing will make an important contribution to ensuring the ongoing competitiveness of Lloyd's. Supporting the competitiveness of Lloyd's is in the wider UK interest, given Lloyd's role in the London insurance market and the UK economy.

[1] The main aims of the workstreams are:

- Placement:: to achieve contract certainty at inception of cover; simplify and speed up the contract documentation process; improve processes to measure performance; and reduce the backlog of legacy policies for which no evidence of cover has been produced
- Accounting and settlement:: to implement full electronic processing of accounting and settlement processes between brokers and carriers.
- Claims: to implement an infrastructure that enables the market to negotiate, settle and record claims electronically. (This process includes the development of an electronic repository where a central copy of the claims documentation is kept, available to all interested insurers,)

Lloyd's 2007 Annual Report (p27) confirms that during 2007 over 90% of business benefited from contract certainty on placement and that by end 2007, approximately 75% of all claims were being handled electronically. On accounting and settlement, at end 2007 65% of original premium income related transactions had been settled using electronic processing; and the paper-based accounting system is now being phased out.

OVERVIEW OF PROPOSALS

2.17 The draft Order provides for eight amendments to the 1982 Act:–

- six governance reforms; and
- two market-related reforms.

2.18 The reforms take account of the changes in the regulatory environment since 1982, and also developments and changes in governance standards, especially improvements in governance standards encouraged through non-statutory Codes, such as the UK Combined Code on Corporate Governance. In line with the general purposes of the 2006 Act, the reforms have a very practical focus. They do not seek to alter the basic constitution of Lloyd's or aspects of the current governance arrangements (such as voting rights), which would not be appropriate for this type of instrument.

2.19 The governance reforms are intended to remove restrictions and administrative burdens principally affecting the operation of the Council. The two market-related reforms remove:

- the restriction that currently requires business at Lloyd's generally to be done via a Lloyd's broker;
- the so-called "divestment" provisions, which seek to prohibit certain associations between managing agents and brokers in order to help manage conflicts of interest between brokers and managing agents.

These changes will level the playing field between Lloyd's and its international wholesale insurance competitors and give Lloyd's greater flexibility in developing its market distribution strategy while ensuring that appropriate mechanisms for governing conflicts of interest remain in place.

3 Ministerial duties under the 2006 Act

3.1 Section 13 of the 2006 Act lays a number of duties on Ministers regarding public consultation on proposals that they intend to make under the Act.

3.2 Treasury Ministers (the Exchequer Secretary and the Economic Secretary) have fulfilled the obligations laid down to undertake full and extensive consultation on the LRO proposals through the Treasury consultation exercises described below.

3.3 The Economic Secretary to the Treasury has assessed the responses to the consultation, and in the light of these has decided that it is appropriate to proceed with the proposals in the draft Order. The Minister is satisfied that the Order serves the purpose set out in section 1(2) of the 2006 Act; and meets the conditions imposed by section 3(2) of that Act.

Overview of Treasury consultation

3.4 Following the Government announcement in June 2007 (para 2.15), the Treasury worked through the autumn to develop proposals for the LRO, working with the Society of Lloyd's. To inform the policy development process, the Treasury had conversations with a range of stakeholders in the Lloyd's market at end 2007 and in January 2008, including representatives of:

- Lloyd's individual members, through the Association of Lloyd's Members (representing c 1,200 actively underwriting members) and the High Premium Group;
- members' agents and advisers;
- managing agents (through the Lloyd's Market Association (LMA)); and
- Lloyd's brokers (through the London Market Insurance Brokers' Committee (LMBC)).

3.5 The Treasury conducted a full public consultation on the LRO proposals in the Spring. The consultation ran for three months, from 7 March 2008 until 30 May 2008: (a copy of the consultation document may be found at http://www.hm-treasury.gov.uk/consultations_and_legislation/consult_fullindex.cfm#closed).

3.6 The Chairman of Lloyd's wrote to all members of the Society, drawing their attention to the consultation proposals and to how they could make their views known. Separately, HM Treasury sent a letter to 258 individuals and organisations, including all Lloyd's brokers and managing agents, to the main market representative organisations, and to individuals who had previously expressed an interest in the consultation exercise (see Annex B).

3.7 In addition, Treasury officials held a series of meetings during the consultation period with individuals and representative organisations with a particular interest in the content of the LRO. These included meetings with the LMA and the LMBC and meetings with representatives of members, managing agents and members' agents, as well as meetings with Lloyd's brokers.

3.8 As noted in its formal response, the Society of Lloyd's held an Extraordinary General Meeting of the Society on 21 May 2008, to give members an opportunity to

discuss the proposals and express their views. The meeting was invited to vote on the following resolution:-

> *"THAT the Society consents to the proposals for amendments to Lloyd's Act 1982 described in the Consultation Document "Proposals for a Legislative Reform Order to amend Lloyd's Act 1982" published by HM Treasury in March 2008 to be made by an Order of two of the Lords Commissioners of HM Treasury under the Legislative and Regulatory Reform Act 2006 (a draft of the Order is set out in the Annex to the Consultation Document);*
>
> *THAT the Society authorises the Council or a sub-group appointed by it for these purposes to consider and agree to any variations to those proposals."*

3.9 In accordance with Lloyd's rules the vote on the resolution was on a capacity weighted basis. 99.14% of the members voted in favour of the resolution. The turnout was 51.77%.

OVERVIEW OF CONSULTATION RESPONSES

3.10 The Treasury received 69 responses to the consultation, from 66 respondents. Respondents included Lloyd's (submitting a formal response), the ALM, the LMA, the LMBC, three members' agents, the Institute of Insurance Brokers, several City institutions, City law and accounting firms. In addition there were responses from several individuals associated with Lloyd's (including a past Chairman) and a number of Names (see Annex C).

3.11 Some respondents commented in relation to all or most of the proposals included in the draft Order. Others commented only in relation to one or more of the proposals. The level of support expressed for each of the proposals by those commenting on that proposal is set out in the table overleaf. Of all the proposals, the market reforms attracted the most comment; however there were also many comments on the governance reforms, particularly the first two.

3.12 Suggestions for action in addition to the Government's proposals were received from 20 respondents. 11 of these respondents were individual Lloyd's members who made no comment on the Government's proposed reforms but sent in identical letters of support for a set of additional proposals suggested by a Lloyd's Name. The Government does not believe that any of these additional proposals can be included in the LRO; but a full discussion of all the points these respondents raised is set out in Chapter 6.

3.13 Three respondents suggested that the Government should be focusing on other reforms, which they felt would benefit members as a precursor to, or instead of, the Government's proposed reforms. These included specific issues or requests for action also raised by others responding to the Government's proposals, in particular regarding Lloyd's statutory immunity. These points are also addressed in Chapter 6.

3.14 Only 12 respondents raised any objection to the proposals made in the draft Order. In six cases, the objection made only concerned proposal 7 (removal of the restriction that requires managing agents generally to accept or place business only from or through a Lloyd's broker). In three cases, the respondents opposed the Government's proposals on the ground that the proposed Order was an inappropriate use of the powers under the 2006 Act (see paragraphs 3.15 – 3.17 below).

Analysis of responses

	Proposal	Number of Responses	For	Unsure	Against
1	Relax rules on appointments of Chairman/Deputy Chairman of Council	41	93%	2%	5%
2	Relax rules on elections to Council	44	89%	4%	7%
3	Remove the requirement for Governor of the Bank of England to approve Council's nominated members.	41	98%	-	2%
4	Remove the (little used) Committee	41	95%	-	5%
5	Reform the delegation rules	43	95%	-	5%
6	Relax rules on disciplinary committees	41	95%	-	5%
7	Remove restriction on market access concerning Lloyd's brokers	48	79%	4%	17%
8	Repeal the divestment provision	45	89%	2%	9%

OBJECTIONS TO THE USE OF THE 2006 ACT

3.15 Those respondents who argued that the proposed Order was an inappropriate use of the powers under the 2006 Act expressed concern that the draft Order was being used to make significant amendments to a local Act that had first been introduced into Parliament as a private Bill following an extensive process of consultation with the membership, and that had been passed after full discussion in Parliament. It was noted that, in contrast to a private Bill, there is no right of objection by way of petition to Parliament to an order under the 2006 Act. These responses also criticised the Treasury consultation as being insufficient.

3.16 One of these respondents suggested that the powers granted by the 2006 Act were intended to enable further implementation of Community law, and should not therefore be used for proposals which are not designed to implement any change in Community law. This is a misunderstanding of the purpose of the 2006 Act.

3.17 Another of these respondents also expressed the view that proposals 1, 2 and 4 could not be included in an Order made under the 2006 Act on the grounds that they are of constitutional significance, and do not therefore satisfy the precondition set out in section 3(2)(f) of the 2006 Act. However, though these proposals do affect the constitution of Lloyd's, the Government does not consider that they have any significance for the constitution of this country. It is therefore of the view, noted in paragraph 4.2 below, that these proposals do satisfy section 3(2)(f) of the 2006 Act.

DEVOLVED ADMINISTRATIONS

3.18 Since Lloyd's Act 1982 is a local Act, it does not directly cover devolved matters. However, the proposal to deregulate broker access to Lloyd's could, in principle, make it easier for businesses in Scotland and Wales to access the Lloyd's market directly, or to do so by using local brokers, rather than those in England. Treasury officials have spoken to officials in the devolved administrations who have confirmed that whilst their Ministers have no direct interest in the LRO, they are nonetheless content for it to proceed.

MINISTER'S RECOMMENDED PARLIAMENTARY PROCESS

3.19 Treasury Ministers recommend that the draft Order and the Explanatory Document should be laid in Parliament under the affirmative resolution procedure for which provision is made by section 17 of the 2006 Act. This procedure was chosen because, as noted in the Consultation Document "Proposals for a Legislative Reform Order to amend Lloyd's Act 1982", though the Order being made is not complex, and is limited in its effects to the Society of Lloyd's and those working in the Lloyd's market, this is the first time on which an order under the 2006 Act is being used to amend a local Act. It therefore seems appropriate for the draft Order to receive a degree of Parliamentary scrutiny greater than that which would be available under the negative resolution procedure. However, as the Order does not contain any proposals of wider political or public importance, Ministers believe that there is little justification for the use of the super-affirmative procedure provided for in section 18 of the 2006 Act.

3.20 This conclusion has been supported by most of the thirteen responses received to the consultation paper which considered this point. Eleven respondents expressly agreed that the draft Order should be subject to the affirmative resolution procedure. Only two respondents called for the use of the super affirmative procedure. In one case this was on the basis of the respondent's desire for the LRO to be amended to include additional provisions, suggested in their response. As Ministers consider that the proposals in question would be outside the scope of the 2006 Act, it is not possible for the LRO to be amended to give effect to these proposals. The other respondent suggested that the super affirmative procedure should be used given the constitutional nature of the proposals 1, 2, 4. For the reasons set out in paragraphs 4.2 and 5.2 below, the Government does not consider that any of the proposals which are given effect by the draft Order are of constitutional significance to this country. Nor does it consider that they make fundamental changes to the constitution of Lloyd's. Accordingly, the Government remains of the view that the draft Order should be subject to the affirmative procedure.

COMPATIBILITY WITH THE CONVENTION ON HUMAN RIGHTS

3.21 The Economic Secretary to the Treasury, Kitty Ussher, has made the following statement regarding Human Rights:

> "In my opinion the provisions of the Legislative Reform (Lloyd's) Order 2008 are compatible with the Convention rights."

3.22 Except for the provisions giving effect to proposals 6 and 7, the Minister does not consider that the provisions set out in this draft Order engage any of the Convention rights protected under the Human Rights Act 1998. For the reasons set out in

paragraphs 4.85, 5.28 and 5.29 below, the Minister does not consider that these provisions contravene any of the Convention rights.

COMPATIBILITY WITH OBLIGATIONS ARISING FROM MEMBERSHIP OF THE EUROPEAN UNION

3.23 It is the Treasury Ministers' view that the proposals included in this LRO are compatible with all the requirements of EU membership and with EU legislation.

4 THE GOVERNANCE REFORMS

4.1 This Chapter provides the background and analysis for the governance reforms, setting out for each proposed reform:

- a summary of the current rule and issue or issues arising;
- an explanation of the amendment or amendments proposed;
- analysis of the amendment(s), in terms of the 2006 Act requirements; and
- comments on the proposal received in consultation and the Government's response to these.

4.2 The Government does not consider that any of the reforms discussed in this Chapter have any implications for the constitution of this country. They amend the governance rules for Lloyd's, which only affect those individuals and corporate bodies who have chosen to be members of the Society. The analysis of the requirements of the 2006 Act set out below does not therefore consider the question whether the provisions proposed are of constitutional significance separately in relation to each proposal.

PROPOSAL 1:

Relax the rule requiring the Chairman and Deputy Chairmen of Lloyd's to be elected from the working members of Council (Section 4, Lloyd's Act 1982)

4.3 Under the current rules, the Council comprises three constituencies[2]:

- elected working members;
- elected external members; and
- nominated members (broadly equivalent to companies' independent non-executive directors) who are appointed by the Council.

Section 4 of Lloyd's Act 1982, however, requires the Chairman and Deputy Chairmen of Lloyd's to be elected only from among the Council's working members.

4.4 The original justification for this rule seems to have been the view that experience of working in the Lloyd's market was essential for effective leadership at Lloyd's. In the 1980s, it was also considered appropriate to look to the working membership for leadership.

4.5 In today's business environment, however, it is recognised that organisations often benefit from outside expertise and perspectives, so the restriction imposed on Lloyd's ability to elect an external candidate as Chairman or Deputy Chairman is an obstacle to the efficiency of the Society. There are also practical considerations: as the

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2 The categories of membership in Lloyd's Act 1982 were designed to ensure the make-up of the Council reflected the different interests among the Lloyd's membership.

A "working member of the Society" is defined in section 2(1) of the 1982 Act as a person who is either (a) a member of the Society who occupies himself principally with the conduct of business at Lloyd's by a Lloyd's broker or underwriting agent or (b) is a member of the Society who is now retired but was so occupied immediately before he retired. External members are those members of the Society who are not working members. They include third party capital (non-working Names) providers and the corporate members.

population of working members has shrunk[3], the number of individuals eligible to be elected as Chairman or Deputy Chairmen has become more limited. Equally, the requirement that an outside candidate must be a working member is a potential disincentive to otherwise qualified outsiders, and increases the complexity of the recruitment process for Lloyd's.

AMENDMENTS PROPOSED: LRO ARTICLE 4

4.6 The Government believes that it is important for Lloyd's to continue to be able to attract the right person for the job for these roles and that the current restriction in the Act is unnecessary. To allow Lloyd's greater freedom to recruit for Chairman and Deputy Chairmen, therefore, the **draft Order amends section 4 of Lloyd's Act 1982, so that the Council can elect any of its members as Chairman and Deputy Chairmen**. However, to ensure that there is an appropriate degree of support from the constituencies represented on Council for the Chairman or Deputy Chairman – especially for someone who is a nominated member – the **draft Order stipulates that in future Council should elect its Chairman and Deputy Chairmen by special resolution**. (Section 4 of Lloyd's Act 1982 as now in force simply requires an annual election: by requiring annual election by the special resolution procedure, the candidate concerned will have to obtain support from a majority of the working members of Council, and separately, from a majority of the external and nominated members of Council.)

4.7 The Government also believes it is important to ensure there remains a balance of different perspectives among the Chairman and Deputy Chairmen between those who have or do not have personal experience of the Lloyd's market. So alongside the relaxation of the rule at section 4, the **draft Order states that if the Chairman is not a working member of the Council, at least one Deputy Chairman of Lloyd's must be a working member of Council**.

REQUIREMENTS OF THE 2006 ACT

4.8 This provision is being made under section 1(1) of the Legislative and Regulatory Reform Act 2006.

How does the proposal remove or reduce burdens?

4.9 The requirement in section 4 of the 1982 Act that the Chairman and Deputy Chairmen must be working members is a burden on the Society, and on potential candidates who are not members of the Society. It is a significant obstacle to the efficiency of the Society, which is obliged to look to a limited (and decreasing) pool of candidates for these positions. There are currently six working members of Council. There are currently 956 individuals who would be eligible for election to the Council as working members. However, in practice, a far smaller number have the necessary calibre, experience and time to stand for the position of Chairman or Deputy Chairman, which severely limits the pool of available candidates under the existing provisions. As a past member of the Council of Lloyd's Nominations, Appointments and Compensation Committee noted in response to the consultation "identifying suitable candidates to approach from the tiny and shrinking universe of eligible parties was already very difficult and getting still harder".

[3] In 1982, there were 4,209 working members plus three non-underwriting working members (Source Lloyd's Annual Report 1982-3). At the start of 2008, according to Lloyd's, there were 956 working members, of whom 553 were non-underwriting working members.

4.10 External candidates who have expertise and experience that Lloyd's would like to use cannot be elected, unless they are prepared to spend the necessary time working at a Lloyd's broker or at a managing agent to qualify as a working member, even if they are in all other respects ideally qualified to be elected Chairman. The burden this requirement involves is illustrated by the process that needed to be undertaken to appoint Lord Levene, the current Chairman. He was required to undertake a period of work at a Lloyd's broker in order that he could qualify as a "working member" of the Society. It was only as a result of that process that he was eligible to stand for election to Council and subsequently be elected as Chairman.

4.11 This process also adds to the burden on the Society, as it is a very significant disincentive to suitable candidates from becoming Chairman. It requires Lloyd's to identify an external candidate a considerable period before they are able to take office simply in order to permit them first to qualify as a working member.

Does the proposal enact, or re-enact, burdens?

4.12 The LRO proposal will remove the requirement for the Chairman and the Deputy Chairmen to be elected from the working members of the Council. It will be replaced by a requirement that, where the Chairman is not a working member of Council, one of the Deputy Chairmen must be a working member. Although there will therefore still be a restriction on appointment to these offices, it will be significantly less burdensome than the current rule. There will also be a requirement that the Council should elect the Chairman and Deputy Chairmen by special resolution, requiring a majority of the working members of the Council as well as a majority of the external and nominated members of the Council. However, these restrictions will not impose a significant burden on the Society, and the Government considers that they are necessary to ensure a fair balance between the interests of the working members and the other members of the Society.

Could the policy objective be secured by non-legislative means?

4.13 The rule that the Chairman and Deputy Chairmen of Lloyd's must be working members is set out in section 4 of Lloyd's Act 1982, and can only be removed by amending that section.

Is the provision proportionate, and fair?

4.14 Removal of the rule will enable the Society to gain by being able to search within a wider field to find a candidate with the necessary expertise to hold one of these positions, and where appropriate, bring candidates with external experience and contacts into the Society. However working members of the Council will remain eligible for election to these positions, and the election of a Chairman or Deputy Chairman will require a special resolution of the Council, which can only be passed by a majority both of the working members of the Council, and of the non-working members of the Council (that is, the external members and nominated members of Council). The position of the working members will be further safeguarded by the requirement that, where the Chairman who is elected is not a working member of the Society, at least one of the Deputy Chairmen must be elected from among the working members of the Society. The Government considers that this provision is proportionate, and that it strikes a fair balance between the interests of the Society and the interests of the working members of the Society.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

4.15 No. The existing rule could be described as a protection for the position of working members. However, the proposal to open up election as Chairman or Deputy Chairman of the Society of Lloyd's to people who are not working members of the Society has been balanced by the introduction of measures to safeguard the position of working members. Accordingly the Government does not consider that the proposal removes any necessary protections, or that it affects the exercise of any right or freedom, and none of the responses received by the Treasury to the consultation document suggest otherwise.

CONSULTATION REACTION AND GOVERNMENT RESPONSE

4.16 Out of the 41 respondents that considered this proposal, **38 (93%) were in favour, 1 (2%) had reservations and 2 (5%) objected**. Eleven of the written responses that commented specifically on this proposal gave unreserved support, with several noting the importance of Lloyd's being able to choose its management from as broad a group as possible.

4.17 The Lloyd's Market Association noted that some members of its Board felt that the Chairman and Deputy Chairmen should continue to be drawn from among the working members. Another respondent expressed similar thoughts, though not suggesting this should be a matter for statute.

4.18 The Association of Lloyd's Members, while supporting the reform, suggested that it was important to ensure that only one of the Chairman and Deputy Chairmen was not a working member; while one of the members' agents suggested that it would be preferable if Lloyd's maintained an even ratio (2:2) among the four posts of Chairman/Deputy Chairman and senior nominated member of Council[4]. The Government believes that in terms of statutory limits, the proposal made in the LRO provides the right result and that setting alternative ratios or limits in statute would be too prescriptive. Lloyd's will be able to limit the terms which may be served by anyone holding a particular position by byelaw if this is seen to be appropriate.

4.19 One corporate member suggested in its response that the election of the Chairman by the special resolution procedure was unnecessary: however, the Government continues to feel that the slight tightening of the election procedure is a proportionate measure which will ensure that no necessary protections are removed for working members in particular by relaxation of the Section 4 rule.

4.20 Those objecting to the proposal disagreed with the Government's assessment that the change was necessary, or suggested that the reforms would not reduce a burden. One argued that Lloyd's experience showed that it was possible to find a "work-around" to recruit external candidates to the role of Chairman. However, for the reasons set out above, the Government believes that the current requirement constitutes an unnecessary burden on the Society.

[4] Currently Bill Knight, Chairman of Lloyd's NACC, who is given the title of Deputy Chairman of Council.

PROPOSAL 2:

Remove the restrictions on elections to Council to create greater flexibility and to permit greater alignment with the Combined Code on Corporate Governance (Section 3(5)(ii)-(iii), Lloyd's Act 1982)

4.21 The current rules concerning elections to the Council contain a number of restrictions on elections of working members. In particular, a working member of Council (other than the Chairman or Deputy Chairmen) cannot serve consecutive terms on Council, since the Act requires a minimum of a year's break between terms for working members. The Act says nothing about the permitted terms for external members or for nominated members. This is left to Lloyd's to regulate under its byelaws.

4.22 The restrictions for working members seem to have been designed in the expectation that there would be a regular turnover of working members on Council. However, the rules now seem overly burdensome as they prevent continuity of service, even where this would be beneficial or the relevant voting constituencies would like to see the member continue on Council.

AMENDMENTS PROPOSED: LRO ARTICLE 3(3)

4.23 The Government believes that Lloyd's should have greater freedom to make provision on the question of elections under its byelaws. This would allow Lloyd's to align the rules on the terms that may be served by all members of the Council with principles of good corporate governance (as set out currently in the Combined Code on Corporate Governance).

4.24 The Government sought views as to whether there should be a set limit to the number of years a member of Council can serve as Chairman. Relatively few respondents answered this question, and there was no consensus among those who did. The Government considers however, that on balance the weight of opinion was in favour of no statutory limit.

4.25 The **draft Order therefore removes the restrictions at Lloyd's Act s3(5)(ii)-(iii), by repealing these provisions**. The question of the aggregate number of years that a Chairman may serve in that office is left to regulation by the Council in accordance with the principles of good corporate governance. Lloyd's has confirmed that it will recommend to Council that it implement byelaw provisions to restrict any member of Council other than the Chief Executive Officer to a maximum aggregate limit of nine years in total. The Government notes that such a maximum term of nine years would be in line with the Combined Code A7.2.

REQUIREMENTS OF THE 2006 ACT

4.26 These provisions are being made under section 1(1) of the Legislative and Regulatory Reform Act 2006.

How does the proposal remove or reduce burdens?

4.27 The requirement in paragraph (ii) of section 3(5) that working members of the Council must leave the Council for at least a year after each term imposes a burden on Lloyd's both in terms of administrative inconvenience and as an obstacle to efficiency.

Members of the Council (of whatever constituency) develop significant knowledge in relation to the issues facing the Lloyd's market, and the governing bodies of the Society during their time on the Council. The requirement that they must leave the Council for at least a year after a term effectively deprives the Council, and the Society, of the expertise they have gained. This is a particular problem where the member concerned is making an important contribution to a Council project, which is continuing beyond his term. The fact that he is obliged to stand down, even where his constituency wishes to re-elect him, means that continuity is lost, hindering the efficiency of the Council[5].

4.28 Under the LRO proposal, there will be no statutory restriction on the number of consecutive terms which working members can serve. They will be in the same position as external and nominated members of the Council. Equally, the Chairman and Deputy Chairmen will be able to stand for election for more than two terms as a member of the Council. It will be for the Society of Lloyd's to determine what terms of office may be served by members of Council in each constituency by byelaw.

Could the policy objective be secured by non-legislative means?

4.29 No. The relevant rules are set out in section 3(5)(ii) to (iii) of Lloyd's Act 1982. They can only be changed if this section is amended by legislation.

Is the provision proportionate, and fair?

4.30 The Government considers that the effect of these proposals is proportionate to the policy objective. The rules on the terms of office which may be served by working members of the Council, and by the Chairman and Deputy Chairmen, will be relaxed, but it will still be necessary for Council members to be re-elected to the Council by their constituencies, and for the Chairman and Deputy Chairmen to be elected to their respective offices by a special resolution of the Council, requiring a majority of both the working members, and the non-working members on the Council. This will remove a burden, without adversely affecting the interests of any constituency of Lloyd's members.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

4.31 No. If a majority of the working members of the Society believe that a particular member should not stand for a further term, they will be able to prevent this by voting for another candidate. The Chairman and Deputy Chairmen must also stand for annual election by Council members under section 4 of Lloyd's Act 1982, if they are to retain their positions. The Government therefore does not consider that the proposals remove any necessary protections, or that anyone will be prevented from exercising a right or freedom.

CONSULTATION REACTION AND GOVERNMENT RESPONSE

4.32 Of the 44 respondents that commented specifically on this proposal, **39 (89%) were in principle in favour of a relaxation of the rules on elections to Council, 2 (4%) expressed reservations and 3 (7%) were against**. One of the objectors stated that this provision was an important protection for investors, preventing a minority of working names exercising undue influence. The others felt that the case for the change had not

[5] Records of the working members who have served on Council show many were re-elected back onto Council as soon as their one-year break was completed.

been made. For the reasons set out in paragraph 4.31 above, the Government does not consider that this proposal will remove a necessary protection for members of the Society.

4.33 Only 14 respondents commented on the question posed by the Government in paragraph 1.14 of the Consultation Paper. Opinion was divided as to whether there should be a statutory restriction on the maximum number of years in aggregate that a member of Council can serve as Chairman, and if so what that limit should be. The argument against any statutory restriction (put most strongly by the Council of Lloyd's and also by the Association of Lloyd's Members) was that the matter should be left to the Council to regulate by byelaw. This would allow flexibility, if the rules needed to be adjusted again in future to keep in step with generally accepted standards of good governance. Support for this position also came from 3 other respondents, one of whom felt that there should be no restriction, subject to the normal expectations of disclosure (i.e. that Lloyd's should be expected to comply with the Code on Corporate Governance and to explain where the Code is not being followed).

4.34 Five respondents supported a limit of nine years (the Government's suggested figure). Two others supported a limit of 6 years, while two preferred 3 or 3-5 years. Those supporting a limit felt that this would be a prudent control, as absence of a statutory limit could lead to inertia or create cliques on the Council. One of those objecting felt that the existing rules were closer to the provisions of the Combined Code than the Government's proposals.

4.35 In the light of the consultation, the Government believes the best solution would be to remove all statutory restrictions. In absence of such restrictions, however, the Government's view is that Lloyd's byelaws should match current standards of good corporate governance. The Council of Lloyd's has publicly committed to good corporate governance and supports the application of the Combined Code on Corporate Governance, as far as this can be applied to the governance of a Society of members and a market of separate competing entities[6].

4.36 As noted in paragraph 4.25 above, Lloyd's has confirmed that it will recommend to Council that it implement byelaw provisions to restrict any member of Council other than the Chief Executive Officer to a maximum aggregate limit of nine years in total. This will put the rules for all categories of Council members on an equal footing (the byelaws currently restrict length of tenure of external members on Council to six years).

PROPOSAL 3.

Remove the requirement for approval from the Governor of the Bank of England for appointment of nominated members of Council (Section 3(2)(c), Lloyd's Act 1982)

4.37 Currently, the Act requires that appointments of nominated members of Council must be confirmed by the Governor of the Bank of England. This is a historical provision that reflects the regulatory environment of the City before the advent of the Financial Services Authority (FSA).

6 See page 87 of Lloyd's Annual Report 2007

AMENDMENTS PROPOSED: LRO ARTICLE 3(2)

4.38 Given the FSA's regulatory responsibilities include approval of all Council members, the Government considers that the need for this rule has now been superseded. The **draft Order therefore removes this requirement**. The Bank of England supports this proposal.

REQUIREMENTS OF THE 2006 ACT

4.39 This provision is being made under section 1(1) of the Legislative and Regulatory Reform Act 2006.

How does the proposal remove or reduce burdens?

4.40 Section 3(2)(c) of the 1982 Act provides that the appointment of nominated members must be confirmed by the Governor for the time being of the Bank of England. This requires the Governor to duplicate the function of the Financial Services Authority, which as part of its regulatory oversight of Lloyd's must approve all Council members, including the nominated members, under section 59 of the Financial Services and Markets Act 2000. The need for Lloyd's to seek approval from the Governor of the Bank of England imposes a burden in the form of administrative inconvenience on both Lloyd's and the Bank. Removal of the requirement in section 3(2)(c) of the Act will remove this burden.

Could the policy objective be secured by non-legislative means?

4.41 As noted above, the requirement for the appointments of nominated members to be approved by the Governor for the time being of the Bank of England is set out in section 3(2)(c) of Lloyd's Act 1982. There is no non-legislative means of amending this provision.

Is the provision proportionate, and fair?

4.42 The effect of this provision will be that nominated members need only be approved by the Financial Services Authority, under section 59 of the Financial Services and Markets Act 2000, before they can be appointed to the Council. This will not reduce the level of scrutiny received by the nominated members before their appointment, but will remove the need for the Governor to duplicate the approval process carried out by the Financial Services Authority. The Governor of the Bank of England has indicated that he is content for this requirement to be removed.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

4.43 The Government believes that the continuing requirement that nominated members of the Council must be approved by the FSA will ensure that removal of the need for approval of these appointments will not remove any protection for members. No such approval may be given unless the Authority is satisfied that the person concerned is a fit and proper person to perform the function of a member of the Council, a test which requires a review of the honesty, integrity and reputation of the person concerned, as well as their competence and capability and financial soundness[7].

[7] FSA Handbook FIT 1.3.

4.44 This proposal does not prevent any person from exercising any existing right or freedom which he might continue to exercise.

CONSULTATION REACTION AND GOVERNMENT RESPONSE

4.45 Of the 41 respondents who responded to this proposal **40 (98%) were in favour and 1 (2%) objected**.

4.46 Of those responding in favour, one requested greater transparency in the workings of Lloyd's NACC (Nominations, Appointments and Compensation Committee). Three others suggested that the FSA's role should involve consideration of wider questions of suitability, for example regarding independence. The one respondent objecting to this proposal felt that it was not clear that the FSA did have to approve all Council members under section 59 of FSMA. The FSA has however confirmed that they do approve all Council members under this provision.

4.47 The Government believes the question of suitability of particular nominated members is primarily for Lloyd's (as one of the responses above also stated). Similarly, the issue of transparency regarding the workings of NACC is a matter for Lloyd's.

PROPOSAL 4

Remove the provisions establishing the Committee of Lloyd's (Section 5, Lloyd's Act 1982)

4.48 Section 5 of the 1982 Act establishes the Committee of Lloyd's, which comprises the working members of the Council. When the Act was passed, the expectation was that the Committee would be the primary executive body of the Society that managed all the detailed decision-making relating to the market.

4.49 However the Committee is now little used. Instead, since 1993, Lloyd's has developed alternative governance structures to meet market needs that have drawn on expertise from a variety of sources within the market as well as independent expertise. These bodies were set up under other powers under the Act and include:

- the Franchise Board (which first met in 2003 and now undertakes a key role in the governance of Lloyd's – see Chapter 2), and prior to that,
- the Lloyd's Market Board (LMB) and the Lloyd's Regulatory Board (LRB)[8].

AMENDMENTS PROPOSED: LRO ARTICLES 5 AND 6

4.50 Given the fact that the Committee is now effectively redundant, **the draft Order repeals section 5 and removes other references to the Committee from the 1982 Act, while making provision (in Article 6) for those cases where a decision of the Committee is still required** (for example, in some cases, to enable the release of Funds at Lloyd's to Names).

[8] Aside from the formal delegation powers, section 6(7) Lloyd's Act 1982 permits the Council to set up bodies or committees etc through which it can act, whose members involve individuals who are not members of the Society. The LMB and LRB were sub-committees of the Council set up under section 6(7), as is the Franchise Board.

REQUIREMENTS OF THE 2006 ACT

4.51 These provisions are being made using powers under section 1(1) and (8) of the 2006 Act.

How does the proposal remove or reduce burdens?

4.52 Abolition of the Committee will remove the administrative inconvenience that arises from having to maintain the Committee and provide it with administrative support. The Committee's business, though limited, requires some formalities such as the annual election of the Committee Chairman/ Deputy Chairmen. This can be removed by repealing the provisions setting up the Committee.

Could the policy objective be secured by non-legislative means?

4.53 As the establishment of the Committee is required by section 5 of Lloyd's Act 1982, it cannot be removed unless that section is repealed. There is no non-legislative means of doing this.

Is the provision proportionate, and fair?

4.54 The removal of the Committee will not affect the position of the working members on the Council. All decisions requiring a special resolution, such as the enactment of byelaws governing the operation of the Lloyd's market, will need to have the support of a majority of the working members, as well as a majority of the other members of Council. In addition, this proposal will not prevent the Council subsequently creating a non-statutory committee formed only of the working members of the Council if that is felt to be beneficial. It will only remove the statutory obligation for Lloyd's to have, and to provide administrative support for, such a committee. Equally, the removal of the Committee will not adversely affect other members.

4.55 The Government therefore believes the policy is proportionate and fair, and in particular that it strikes a fair balance between the interests of working members and the interests of the Society.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

4.56 As noted above, the interests of working members will not in practice be affected by the removal of the Committee, because of their continuing role on the Council, and in particular the requirement that the most important decisions of the Council must be passed by a special resolution. The proposal does not therefore remove any necessary protection, or prevent any person from continuing to exercise a right or freedom.

CONSULTATION REACTION

4.57 Of the 41 respondents who considered this proposal, **39 (95%) were in favour and 2 (5%) objected**, on the grounds that the proposal was unnecessary, or that it did not remove a burden.

4.58 One respondent, while recording support, suggested that the working member constituency included some kinds of practitioner expertise, which were not reflected in the current composition of the Franchise Board and that including such expertise would be beneficial for Lloyd's/Franchise Board. The Government believes that this is a

matter for Lloyd's – since, just as the Council can establish a committee in future solely composed of working members, there is nothing to prevent the Council adjusting the composition of the Franchise Board in future if this is felt to be desirable.

PROPOSAL 5

Reform the delegation rules (Section 6(5)-(6), Lloyd's Act 1982)

4.59 The Act currently contains detailed rules concerning delegation to the Committee and its Chairmen and Deputy Chairmen (reflecting the assumption that the Committee would be used for detailed decision-making relating to the market, subordinate to the Council). As the repeal of section 5 would leave the Council with only very limited delegation powers, the Government considers it necessary to reframe the delegation powers and to make them less restrictive.

AMENDMENTS PROPOSED: LRO ARTICLE 7

4.60 In making the delegation powers less restrictive, the Government does not wish to disturb the position in relation to the Council's reserved powers. So the Government is not suggesting any change to the rule currently at section 6(5) of Lloyd's Act 1982 that the Council may not delegate any powers that are currently only exercisable by special resolution. This means the Council will still deal with matters such as appointments of nominated members of Council and, crucially, the making, amending or revocation of byelaws.

4.61 Apart from the reserved powers, however, **the draft Order permits the Council to delegate matters by special resolution on such terms as it considers appropriate, to whatever committees, sub-committees, other bodies or other persons as it sees fit**. If wished, the Council will be able to authorise further sub-delegation of the powers being delegated under the terms of a delegation.

4.62 The revised delegation rules are modelled on the powers of directors of a public limited company as set out in the draft Companies (Model Articles) Regulations published by the Department for Business, Enterprise and Regulatory Reform. (See extract from draft Articles of Association for public limited companies, overleaf). For full details see: http://www.berr.gov.uk/bbf/co-act-2006/draft/page40411.html.

4.63 The reform will provide greater clarity. This will ensure that the technical uncertainties about the scope of the current powers, which have given rise to challenges before Lloyd's Appeal Tribunal (at a cost to Lloyd's of £10,000s) can be avoided.

Extract from Draft Articles of Association

SCHEDULE 1 Paragraph 5

DRAFT MODEL ARTICLES FOR PUBLIC COMPANIES

Directors may delegate

5.—(1) Subject to the articles, the directors may delegate any of the powers which are conferred on them under the articles—

(a) to such person or committee;

(b) by such means (including by power of attorney);

(c) to such an extent;

(d) in relation to such matters or territories; and

(e) on such terms and conditions

as they think fit.

(2) If the directors so specify, any such delegation may authorise further delegation of the directors' powers by any person to whom they are delegated.

(3) The directors may revoke any delegation in whole or part, or alter its terms and conditions.

REQUIREMENTS OF THE 2006 ACT

4.64 This provision is being made under section 1(1) and 1(8) of the Legislative and Regulatory Reform Act 2006.

4.65 The Council's powers to delegate its powers or functions are governed by sections 6(5) to (6) of the 1982 Act. Under section 6(6) it may only delegate certain of its functions to the Committee, or (under section 6(6)(b), to the Chairman or a Deputy Chairman of the Committee). The removal of the Committee makes it necessary to amend these provisions.

How does the proposal remove or reduce burdens?

4.66 The limited delegation power imposes a burden on Lloyd's within the meaning of section 1(3) of the 2006 Act in terms of administrative inconvenience and financial costs, which arises from the way the existing provisions are drafted. The restricted nature of the Council's existing powers of delegation mean that, if the Council wishes to work through a body other than the Committee, it must rely on its powers under section 6(7) to act through agents. These arrangements are unusual, and are not readily understood by those dealing with Lloyd's. This can give rise to doubt as to their extent, and the extent to which agents appointed by the Council may themselves act through, or together with, other people or bodies to deliver the functions with which they are entrusted. As the delegation rules will be clearer, technical uncertainties about the scope of the powers under section 6(7) and their relationship with section 6(5) and (6), which have in the past prompted appeals to Lloyd's Appeal Tribunal (imposing financial costs on the Society, and making significant demands on management time), can be avoided.

Could the policy objective be secured by non-legislative means?

4.67 The existing rules on delegation are set out in section 6(5) and (6) of Lloyd's Act 1982. They cannot be changed without an amendment of that provision. There is no non-legislative means of achieving this.

Is the provision proportionate, and fair?

4.68 Proposal 5 is in part a consequential amendment required by the proposed removal of the Committee. The existing powers of delegation enable the Council to delegate some of its powers and functions to the Committee and to its officers, but not otherwise. Once the provisions relating to the Committee have been removed, the Council's powers of delegation would be extremely limited.

4.69 The draft Order does not affect the Council's existing powers to act through agents. This means that existing arrangements that have been created using these powers are not disturbed. The Government believes the resulting rules will be simpler and easier to operate and understand. This should also help to encourage greater clarity about the relationship between the bodies the Council creates to perform specific roles or tasks, and the lines of accountability between those bodies and the Council.

4.70 Any delegation under these provisions must be made by special resolution, and the Council will not be able to delegate any function or power the exercise of which requires a special resolution. The Council will have the power to authorise further delegation of a function which has been delegated on conditions laid down by the Council by special resolution. The Government believes that these proposals are proportionate to the policy objectives and do not have any adverse effect on stakeholders or the general public.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

4.71 The proposals do not remove any necessary protection. The requirement under the existing Act that delegations must be made by the Council by special resolution, and therefore be supported by a majority both of working members and of non-working members of the Council will be retained. Though the provisions will enable the Council to authorise sub-delegation of their functions, as noted above, the terms on which any such sub-delegation is made must be set in conditions laid down by the Council by special resolution. Equally, the Government does not consider that these provisions will prevent anyone from exercising any existing rights or freedoms.

CONSULTATION REACTION

4.72 Of the 43 respondents who considered this proposal, **41 (95%) were in favour and 2 (5%) objected**.

4.73 Two of those endorsing the proposal particularly welcomed the fact that the Council's reserved powers were not being disturbed, while a past member of the Council of Lloyd's noted that he attached particular importance to the need to adapt the current provisions on the powers of delegation of the Council so that they are more closely aligned with practice in major corporate boards.

4.74 One respondent objected to the proposal because he felt this reform would weaken the Council's control over decision making. Another respondent objected on the grounds that the new delegation rules will be more arbitrary, that they lack the

requirement for ratification contained in the old provisions, and that they do not contain a requirement for delegations and sub-delegations made under these provisions to be made a matter of public record. The Government notes that the provisions in the 1982 Act do not require delegations made under them to be published, and such a requirement is not commonly incorporated into powers of delegation in relation to other corporate bodies. Any delegation or grant of a power to sub-delegate must be made by the Council by special resolution; and all members of the Council will therefore have the opportunity to be party to the decision and will be able to ask the Council to consider delegations made at subsequent Council meetings. It is not therefore necessary to include the ratification provisions from section 6(8) of the 1982 Act which were intended to ensure that regulations made by the Committee in the exercise of powers delegated to it could be subjected to scrutiny by the Council.

PROPOSAL 6

Relax the rules on membership of Lloyd's Disciplinary Committee (Section 7(1)(a)(i) Lloyd's Act 1982)

4.75 Section 7 of Lloyd's Act 1982 provides the rules for the establishment and function of Lloyd's Disciplinary Committees, for the proper regulation of the market.

4.76 Section 7(1) currently requires that the majority of members of any Disciplinary Committee established by the Council are members of the Society. This rule was intended to ensure the Disciplinary Committees had an appropriate level of knowledge of the market and involved an element of "peer review" from representative members of the market. However, several factors suggest that the rule is now out-of-date and imposes an unreasonable burden on Lloyd's. First, as part of a wider trend, greater stress is being placed on the need for such committees to have independent input and at least one member who is legally qualified. The current rule does not reflect this. Second, as the composition of the membership has changed, the rule does not serve as well as it did in the past to capture a representative sample of those involved in working in the market. (For example, directors of corporate members are subject to Lloyd's disciplinary procedures but will not generally themselves be members.) Third, as a practical matter, it is clear Lloyd's has experienced difficulties in finding sufficient individuals who have the time and necessary qualifications to serve on the Disciplinary Committees.

AMENDMENTS PROPOSED: LRO ARTICLE 8

4.77 To address these issues, **the draft Order removes the requirement that the majority of the members of the Disciplinary Committees must be members of the Society**. At the same time, to ensure that the Disciplinary Committees contain at least one individual who can be expected to have familiarity with the market, **the draft Order stipulates that Disciplinary Committees must include at least one individual from one of the following classes of persons**:

- working members of the Society;
- directors of corporate members;

- officers and employees of underwriting agents[9] or of Lloyd's brokers who have been approved by the FSA under section 59 of the Financial Services and Markets Act 2000;
- anyone who fell into one of the above categories before their retirement.

REQUIREMENTS OF THE 2006 ACT

4.78 This provision is being made under section 1(1) of the Legislative and Regulatory Reform Act 2006. It will give Lloyd's greater freedom to make suitable appointments to its Disciplinary Committees, according to the circumstances of a particular case. It will not prevent individual external members serving on Disciplinary Committees, where they have appropriate knowledge or experience and are available to serve.

How does the proposal remove or reduce burdens?

4.79 At the time when the Act was passed there were 20,000 individual members of the Society. At the start of 2008 there were only 5,987 individual external members and working members of the Society who could qualify to form part of the majority on a Disciplinary Committee. Out of the number of individual members only 907 are actively underwriting members, and 553 are "non-underwriting working members", a total of 1,460. In practice only individual members are capable of being appointed to Disciplinary Committees and may therefore form part of the majority of members of the Society required by the Act. Corporate members (who now provide 90% of the underwriting capacity on the Lloyd's market) and their officers and employees may not count as part of the "majority" of members for these purposes, because each member of the majority must be a member of Lloyd's in his or her own right. The experience of the Chairman of the Lloyd's Enforcement Board (responsible for the appointment of members of Disciplinary Committees), is that the current provisions create significant difficulties in locating and appointing appropriate[10] and willing members of Disciplinary Committees.

4.80 Accordingly, the Government considers that the current provisions impose a burden on Lloyd's in the sense of an administrative inconvenience.

Does the proposal enact or re-enact burdens?

4.81 The requirement that the majority of members on a disciplinary committee must be members of the Society will be replaced by a requirement that such committees must contain at least one person who falls within one of the categories listed in section 7(1A) as inserted by article 8(4) of the draft Order. This is less restrictive than the requirement in section 7(1)(a)(i) as it is currently in force, and the overall effect of making this change will be to reduce the burden imposed on the Society of Lloyd's under section 7 of the 1982 Act.

Could the policy objective be secured by non-legislative means?

4.82 It is not possible to remove the requirement in section 7(1)(a)(i) that the majority of members of any disciplinary committee should be members of the Society without amending that section. There is no non-legislative means of doing this.

[9] Note: this term includes officers and employees of members' agents, as well as managing agents.

[10] That is, members who not only have the relevant market expertise, but who are also not subject to a conflict of interest in a particular case.

Is the provision proportionate, and fair?

4.83 This provision will make it possible for the majority on any disciplinary committee to be independent of the Society, and for greater use to be made of people who have considerable experience of the Lloyd's market, but who have relinquished their membership of the Society on retirement. The requirement that one member of the committee must be within one of the categories to be listed in section 7(1)(c) will ensure there is at least one person on the committee who can be expected to have sufficient expertise to be able to advise other members of the committee on market practice. (The rule will not prevent external members serving on the committee as they can now.) The Government considers that the effect of this provision will be proportionate to the policy objective of increasing the pool of people available to serve on disciplinary committees of the Society, and does not consider that the proposal will have any adverse effect on stakeholders or the general public.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

4.84 No. Any protective value which might be inherent in the requirement that the majority of the members of a disciplinary committee must be members of the Society will be adequately satisfied by ensuring that such committees have someone with the relevant expertise to ensure that the committee is appropriately advised on market practice. No-one will be prevented from continuing to exercising any right or freedom by this proposal.

HUMAN RIGHTS

4.85 Article 8 of the draft Order amends the rules on the composition of a Disciplinary Committee set out in section 7 of the 1982 Act. Article 6 of the ECHR establishes the right to a fair trial for the determination of any civil rights or obligations. Disciplinary proceedings may involve disputes over civil rights and obligations, where the tribunal is able to suspend a person from professional practice[11]. As the sanctions available to Lloyd's Disciplinary Committees include suspension of the right to act as a Lloyd's broker or underwriter, Article 6 may be engaged in some cases. The Government has therefore considered whether this proposal would in any way prevent the requirements for a fair trial being satisfied. It has concluded that it would not. On the contrary, removing the requirement that a majority on a Disciplinary Committee must be members of the Society will assist Lloyd's in ensuring that such Committees are more independent of the Society. It will not affect any right for the decisions of Disciplinary Committees to be challenged in the courts, or in any way prejudice the rights guaranteed by Article 6.

[11] Albert and Le Compte v Belgium (1983) 5 EHRR 533, para 28.

CONSULTATION REACTION

4.86 Of the 41 respondents who considered this proposal, **39 (95%) were in favour and 2 (5%) objected.**

4.87 Among those in favour, one respondent noted that "increasing the scope for bringing external members on to disciplinary committees will also bring Lloyd's into line with the practice in other markets and professional bodies". Another respondent also welcomed the fact that this would make it easier to ensure the disciplinary committees included high quality, practicing lawyers.

4.88 One respondent, while supporting, wondered whether the list of market practitioners intended to give comfort in terms of provision of expert advice was too broad, since there might need to be two working members (depending on the circumstances of the case) to ensure adequate knowledge and no conflict of interest between the non-legal members on the panel. The Government acknowledges that in certain circumstances, inclusion of two working members on the disciplinary committee might be desirable, but believes it would constitute an inappropriate restriction to require inclusion of two working members for all cases. As the proposed reform only sets a minimum requirement, it will in any case be open to Lloyd's to ensure a suitable staffing of panels for any individual case.

4.89 The main objection to this proposal was from a member who felt that the traditional arrangements were preferable on principle because members should be "judged by their peers". The Government has framed its proposals to ensure an element of peer review continues; however, it believes other considerations mean that more flexibility is now needed to incorporate other expertise.

5 MARKET-RELATED REFORMS

5.1 In addition to the governance-related reforms, the Government also proposes two market-related reforms. These reforms attracted most comment from respondents. As with Chapter 4, this Chapter provides the background and analysis for each of the market reforms, setting out:

- a summary of the current rule and issue or issues arising;
- an explanation of the amendment or amendments proposed;
- analysis of the amendment(s), in terms of the 2006 Act requirements; and
- comments on the proposal received in consultation and the Government's response to these.

5.2 The Government does not consider that any of the reforms discussed in this Chapter have any implications for the constitution of this country. The amendments of the 1982 Act being proposed here only affect members of the Lloyd's community (and in particular underwriters and Lloyd's brokers) and other brokers who wish to place business into the Lloyd's market. The analysis of the requirements of the 2006 Act set out below does not therefore consider the question whether the provisions proposed are of constitutional significance separately in relation to each proposal.

PROPOSAL 7

Remove the restriction (Section 8(3) Lloyd's Act 1982) that requires managing agents generally to accept or place business only from or through a Lloyd's broker

5.3 Under section 8(3) of the 1982 Act, managing agents are, with limited exceptions, only permitted to do business through a Lloyd's broker. Lloyd's operates a registration process for Lloyd's brokers and Lloyd's brokers have various rights – including the right that applies, for example, to employees of Lloyd's brokers to become working members, and thus participate in the governance of the Society.

5.4 With changes at Lloyd's and increasing globalisation of the wholesale insurance market, there are now several reasons for change.

5.5 First, competitive pressures (which are reshaping the traditional relationship between wholesale insurers and brokers more widely) are prompting Lloyd's managing agents and brokers to seek new routes to reach clients round the world. However, although there are ways in which business can come to the market otherwise than through a Lloyd's broker[12], the statutory restriction at section 8(3) places a limit on how far further routes can be opened up, especially for dealing direct with clients. This creates an obstacle to efficiency and hinders the free development of the market. From Lloyd's perspective, the rule represents a particular burden since it is a statutory restriction that none of its competitors face.

[12] These are (i) coverholder and service company arrangements (i.e. where a syndicate delegates its underwriting authority to a third party); (ii) the placement of reinsurance and the acceptance of reinsurance from another syndicate; (iii) the acceptance of personal lines business, commercial life business and commercial motor business from brokers regulated by the FSA or which have a guarantee from a Lloyd's broker; (iv) the acceptance of business from Lloyd's Reinsurance Company (China) Limited; (v) the acceptance of business constituting "Singapore policies" or "offshore policies" as respectively defined in the Insurance Act (Cap 142) of the Republic of Singapore and; (vi) the acceptance of business through Lloyd's Japan Inc.

5.6 The statutory restriction also represents a potential burden in relation to maintaining a cost-effective platform at Lloyd's. As Lloyd's faces competition from centres like the US, Bermuda and Dublin, it is increasingly important to ensure use of the Lloyd's platform does not involve unnecessary costs for policyholders, including in relation to the way business is placed at Lloyd's. However, by creating a potential barrier to change, the statutory restriction potentially makes it more difficult for Lloyd's to ensure that it remains cost effective both for non-complex and specialist risks to be placed in the market.

5.7 A final reason concerns the changing regulatory landscape. The introduction of a new regulatory regime for insurance mediation in the EU[13] has much reduced Lloyd's regulatory role regarding brokers, since the FSA is now responsible for regulation of all UK intermediaries. (Similarly, all EU brokers are subject to regulation by their home regulator.) As a result of this, Lloyd's has streamlined its broker registration process, recognising the role that managing agents play in performing appropriate counterparty risk assessments on the brokers with which they deal. However, the requirement at section 8(3) means it is currently necessary for Lloyd's to maintain full registration arrangements for every broker who wishes to have direct access to the Lloyd's market. This imposes an administrative burden on the Society.

5.8 The Government believes that a measure of deregulation and the creation of a more open environment would help facilitate efforts within the market to maximise efficiencies and drive down costs of operating and placing business at Lloyd's. By removing the statutory restriction, the market should be able to adapt to future competitive pressures, including by building on the more innovative routes that Lloyd's has started to develop, for the benefit of members, as well as encouraging the exploitation of new technologies to provide cost effective interfaces for business.

5.9 At the same time, the Government recognises the vital role that Lloyd's brokers play, particularly in the complex and specialist classes of business, and the benefits they can offer to managing agents. Also, it seems likely many Lloyd's brokers will continue to want to hold themselves out as Lloyd's brokers and to retain their eligibility to participate in Lloyd's governance arrangements. The Government therefore believes Lloyd's should continue to be able to designate as "Lloyd's brokers" those brokers that wish to carry the Lloyd's name.

5.10 In addition, to ensure that Lloyd's is able to safeguard standards of intermediation to the market (though it is no longer registering all brokers centrally), the Government believes Lloyd's should have express power to regulate on standards for intermediation to the Lloyd's market other than by Lloyd's brokers. Lloyd's has confirmed (see further discussion below) that it intends, following consultation with the market, to recommend to the Council that managing agents be required, by byelaw, to apply the same prudential standards required of Lloyd's brokers to all non-Lloyd's brokers placing business directly into the market.

AMENDMENTS PROPOSED: LRO ARTICLE 9

5.11 To remove the limitation that restricts Lloyd's flexibility to respond to competitive challenges, **the draft Order therefore repeals section 8(3)**.

5.12 Reflecting the need to preserve quality intermediation, **the draft Order makes consequential and supplementary provision to amend the definition of "Lloyd's**

[13] Following the introduction of the Insurance Mediation Directive

broker" in section 2 of the 1982 Act and insert paragraphs into Schedule 2 of Lloyd's Act to confirm that the Council has power to make byelaws:

- **governing the conditions on which underwriting agents may deal with insureds and with intermediaries other than Lloyd's brokers; and**
- **to regulate by byelaw the terms on which permission to use the title "Lloyd's broker" may be granted or withdrawn**.

5.13 The Government believes that this reform will maximise Lloyd's ability to work within the market to create an optimal distribution platform. This will facilitate the modernisation of the market in line with Lloyd's published strategy (in the Chairman's Strategy Group report, which was endorsed by members at an EGM in 2002). It will also bring competitive benefits that should reinforce the traditional strengths of the market and promote greater market efficiency.

REQUIREMENTS OF THE 2006 ACT

5.14 The repeal of section 8(3) by Article 9(3) of the draft Order is being made under section 1(1) of the 2006 Act. The consequential and supplementary changes set out in Article 9(1) – (2), (4) and 9(5) are being made under section 1(8) of the 2006 Act.

How does the proposal remove or reduce burdens?

5.15 Section 8(3) of the 1982 Act provides that underwriting members may only accept or place business from or through a Lloyd's broker, or such other person as the Council may from time to time by byelaw permit. In addition to Lloyd's brokers the Council permits members to accept business through intermediaries known as coverholders. Both Lloyd's brokers and approved coverholders must be individually approved by Lloyd's. The costs of this process are borne by the Lloyd's community.

5.16 The Council has also granted limited permission for members to accept insurance business from restricted categories of persons who are not Lloyd's brokers or approved coverholders where conditions laid down in the Underwriting Byelaw are satisfied[14]. However, the terms of section 8(3) of Lloyd's Act 1982 do not permit the Council to make a byelaw giving underwriting agents general permission to dealing directly with assureds, or through any intermediary whether or not that intermediary has been accredited by the Council. Any exceptions granted must be of limited nature, and cannot affect the general rule. This is an obstacle to efficiency and productivity as it constrains the development of Lloyd's distribution arrangements.

Does the proposal enact, or re-enact burdens?

5.17 No, the draft Order does not impose any new burdens on Lloyd's.

5.18 The class of Lloyd's brokers will be retained, which will require Lloyd's to continue to retain arrangements for granting permission to use that title. However, Lloyd's anticipate these arrangements will incur fewer costs than the current arrangements for registering all Lloyd's brokers, as it will not be necessary for Lloyd's to register those intermediaries having access to the market who do not wish to use the title of "Lloyd's broker" (and who may only wish to deal with a limited number of managing agents).

[14] See footnote 12 above.

5.19 It will be for the Council to determine the terms on which managing agents may do business with intermediaries who are not Lloyd's brokers, or directly with the insured (the Order will give them express power to do this). This may require managing agents to incur costs in checking that the intermediaries with whom they do business comply with the same prudential standards as Lloyd's brokers. However, managing agents already incur due diligence costs with respect to brokers, and they will be able to continue to do business solely through Lloyd's brokers, if they consider this is more appropriate for their business.

Could the policy objective be secured by non-legislative means?

5.20 Section 8(3) permits underwriting members to accept or place business through "such other person as the Council may from time to time permit", in addition to Lloyd's brokers. The Government has considered carefully whether this provision is sufficiently wide to enable the policy objective of giving managing agents freedom to deal with intermediaries other than Lloyd's brokers and to deal directly with insureds without an amendment to this provision and has concluded that it is not. The terms in which section 8(3) is drafted, and its genesis as a response to one of the recommendations of the Report of the Fisher Working Party into self-regulation at Lloyd's, demonstrate that section 8(3) is intended to be a restrictive provision. It gives the Council power to allow limited exceptions to the restriction (a power which has been exercised in the Underwriting Byelaw, see footnote 12 above), but not to pass a byelaw granting a general permission for underwriting agents to deal with intermediaries other than Lloyd's brokers, or directly with insureds, which would render the restrictions in this section meaningless. The Council cannot be given power to achieve this unless the restriction in section 8(3) is removed, which can best be done by a repeal of this provision.

5.21 The Government therefore considers there is no non-legislative way of achieving the policy objective.

Is the provision proportionate, and fair?

5.22 Yes. The provisions in the draft Order will enable the Council of Lloyd's to open up the Lloyd's market to other intermediaries, and to allow underwriting agents to deal directly with insureds. Lloyd's brokers' right of access to the Lloyd's market will no longer be set out in statute. As already noted, this right can not be said to be exclusive to Lloyd's brokers, as members have been given permission to deal with other intermediaries or entities in relation to particular classes of business, where the conditions laid down in the byelaw are satisfied. Removing the restriction in section 8(3) of the Act will allow the Council to go further in developing its distribution arrangements in line with changing commercial needs, and increasing the level of competition in the market.

5.23 However the Council will retain the power to impose any restrictions it considers necessary to ensure that, as regards non-Lloyd's brokers, managing agents only do business with intermediaries who meet appropriate prudential standards. At the same time, the class of "Lloyd's broker" is being retained. Lloyd's Act 1982, once amended, will provide that only those permitted by the Council to describe themselves as a "Lloyd's broker" may do so, enabling intermediaries within this category to use the title to demonstrate their specialist knowledge of the Lloyd's market, and thus gain a competitive advantage by comparison with other intermediaries. Individuals working as Lloyd's brokers will continue to be able to become working members of the Society, taking part in its governance, and playing a valuable role in the further development of

the market. The Government considers that the effect of the provision is proportionate to the policy objective, and that it strikes a fair balance between the interests of Lloyd's brokers and the interests of Lloyd's members and the general public.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

5.24 The Government does not consider that this proposal will remove any necessary protections for members of the Lloyd's market, names or policyholders generally. When Lloyd's Act 1982 was passed, insurance brokers were subject to limited regulation under the Insurance Brokers (Registration) Act 1977. It was felt essential for the Society to impose additional regulation on Lloyd's brokers, to ensure that high standards were maintained.

5.25 The position has since changed significantly. Insurance intermediaries operating in the United Kingdom, including Lloyd's brokers, are now subject to regulation by the Financial Services Authority. Insurance intermediaries operating elsewhere in the EU are subject to regulation by the competent authority in their home Member State. UK and EU brokers are regulated in accordance with the requirements of the Insurance Meditation Directive, which require, inter alia, insurance intermediaries to be registered with the competent authority, to satisfy the professional requirements as to knowledge and ability set by that authority, and to hold professional indemnity insurance. Intermediaries from jurisdictions outside the EU will not be subject to the Insurance Mediation Directive. Such intermediaries may currently be approved as Lloyd's brokers provided that they are able to show that they are subject to equivalent regulatory standards.

5.26 The terms on which underwriting agents deal with intermediaries (including intermediaries from jurisdictions outside the EU), and the qualifications which must be possessed by intermediaries before underwriting agents may deal with them, will be regulated by the Council. The Council is also being given power to regulate the terms under which underwriting agents may approach the insured directly. Lloyd's intend to require managing agents to apply the same prudential standards required of Lloyd's brokers to non-Lloyd's brokers placing business directly into the Lloyd's market. Subject to the consultation that Lloyd's will undertake, these standards will include requirements that the broker:

- is properly regulated under the Insurance Mediation Directive, or equivalent standards outside the EU, and is therefore able to demonstrate that it is competent, of good repute and that it has adequate financial capacity;
- is able and willing to enter into a Terms of Business Agreement with each managing agent with whom it intends to place business;
- has adequate, suitable and compatible systems, protocols and arrangements for the conduct of business in the London insurance market;
- has suitable procedures in place to ensure that insurance monies (money relating to premiums, return premiums and claims) are properly safeguarded;
- has adequate professional indemnity insurance of £3 million or four times the annual net retained brokerage (subject to certain caps).

5.27 Nor will this proposal prevent anyone from exercising an existing right or freedom. Lloyd's brokers' own access to the Lloyd's market will not be affected. The class of Lloyd's broker is being retained, as are the rights of those working as Lloyd's brokers to become working members of the Society, and to take part in its governance. As noted above, they will be faced with potential increased competition from other insurance intermediaries, and from underwriting agents wishing to deal directly with assureds. This competition already exists to some degree, as Lloyd's has permitted underwriting agents to do business other than through Lloyd's brokers in certain circumstances. The Government does not therefore consider that its proposals will prevent Lloyd's brokers, or any other member of the Lloyd's community, from exercising an existing right or freedom.

HUMAN RIGHTS

5.28 Section 8(3) ensures that, subject to exceptions prescribed by byelaw, underwriting members are required to deal only through Lloyd's brokers. This provides Lloyd's brokers with a right of access to the Lloyd's market which is set out in statute, and at the same time ensures that other classes of brokers are excluded from the market except as provided for by byelaw. The repeal of this provision does not affect Lloyd's brokers' right to have access to the market, but it does mean that there will no longer be any statutory exclusion of other classes of brokers. The Government has considered whether Article 1, Protocol 1 to the Convention (the right to quiet enjoyment of possessions) is engaged. It has concluded that it is not. The Government does not consider that any rights Lloyd's brokers may have under section 8(3) as currently in force can be classed as a "possession" within the meaning of Article 1. As noted above, that right has been subject to a number of exceptions as the Council of Lloyd's has given permission for managing agents to deal with entities who are not Lloyd's brokers.

5.29 Even assuming that Lloyd's brokers could still be said to have rights capable of constituting a possession, the repeal of section 8(3) is a limited measure taken to further the legitimate aim of opening the market to greater competition, which will not affect Lloyd's brokers' own right to access to the market. The status of Lloyd's broker, indicating specialist knowledge of the Lloyd's market, is being retained, and the repeal is accompanied by safeguards to ensure that the Society of Lloyd's has the power to ensure that managing agents may only deal with brokers satisfying equivalent prudential standards to those which have to be met by Lloyd's brokers. Accordingly, the Government considers that this proposal is a proportionate means of satisfying this aim.

CONSULTATION REACTION

5.30 The proposed reform of section 8(3) generated the most interest and debate during the consultation. It also generated the most substantive responses.

5.31 Of the 48 respondents who considered the proposal, **38 (79%) were in favour, 2 (4%) expressed reservations and 8 (9%) objected**.

5.32 Those in favour of the proposal included the Society of Lloyd's; the Association of Lloyd's Members; the City Corporation; the Lloyd's Market Association, several individual underwriters and underwriting firms, the Institute of Insurance Brokers; three members' agents; and four senior City advisory firms. These respondents recognised the benefits that deregulation could bring, and the potential for efficiencies and cost savings, for example as can be seen in the quote below.

> *"... In our view, the changes will reduce the unnecessary administration and costs involved in placing business only through Lloyd's brokers – a restriction which currently puts Lloyd's syndicates at a disadvantage to those in the companies market. In addition, opening up the market to non-Lloyd's brokers should improve the transparency of the costs of placing a risk on the Lloyd's market, which should ultimately benefit policyholders. The diversification of market participants will help to ensure that Lloyd's meets the demands of a more global insurance market and further help improve access from outside the London market" – City advisory firm*

5.33 Feedback from Lloyd's brokers was more mixed. At the start of the consultation period, a number of brokers read the proposals as indicating that the reform was intended to allow brokers who would not meet the same prudential standards as Lloyd's brokers to access the market[15]. They felt this would lead to lower market standards and would be a detriment to the market. The brokers also felt strongly that the costings provided in the consultation document's partial impact assessment in support of the proposal were incomplete and potentially very misleading.

5.34 In the light of this early reaction, Lloyd's met with various broking representatives to discuss their concerns. Subsequently, Lloyd's has stated to the London Market Insurance Brokers Committee (LMBC) (which represents Lloyd's brokers) that it intends, following consultation with the market, to recommend to the Council that managing agents be required, by byelaw, to apply the same prudential standards required of Lloyd's brokers to all non-Lloyd's brokers (see paragraph 5.26 above).

5.35 In its formal response to the Treasury, the LMBC therefore provided the following comment:

> *"LMBC was most concerned that the result of repealing this section would be that the routes into Lloyd's would be widened considerably and that this might result in unlevel playing fields, together with an increased reputational risk and brand damage. We have recently received assurances of Lloyd's that this will not be the case and that the same prudential standards required from Lloyd's brokers will be extended to all non-Lloyd's brokers placing business into the Market. Given these assurances it is not our intention to comment further on this aspect of the proposed amendments".*

5.36 Besides LMBC, one Lloyd's broker responded in neutral vein, and two positively, expressing the view that section 8(3) was outdated and could be removed, now that assurances had been received from Lloyd's.

5.37 However, six responses were received from brokers, and two from individuals, objecting to the proposals. The six brokers included a mix of larger and smaller broking firms[16]. The brokers rehearsed a number of arguments, including strong concerns about the costings offered in the proposed impact assessment. A summary of respondents' concerns is set out below, grouped thematically, with the Government's response. The issue of costings is covered at paragraphs 5.44 – 5.46 below and in the final impact assessment.

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[15] Two of the other respondents in favour of the reform also sought reassurances as to how the quality of non-Lloyd's brokers would be assured.

[16] In total nine brokers and the LMBC responded to the consultation. The total number of Lloyd's brokers is currently 180.

(i) Lloyd's Act 1982 already provides sufficient flexibility for access to the market.

5.38 The brokers suggested that the existing non-broker routes to the market which the Council has approved demonstrates that the 1982 Act already has sufficient flexibility. One of the individual respondents also objected on this ground. However, as has been made clear (see paragraphs 5.15 – 5.16 and 5.20 above), the Government believes that section 8(3) is a restrictive provision and that it is therefore a barrier to further change.

(ii) Opening up the market will allow poor business into Lloyd's and put Lloyd's brand at risk.

5.39 The second argument made by brokers was that opening up the market would put Lloyd's at risk from poorly regulated or maverick brokers and that business generated from such brokers, or poorly handled business direct from insureds, could increase Lloyd's exposure to financial crime and /or damage the Lloyd's brand. It was also suggested by the other individual respondent that abolition of any distinction between Lloyd's and non-Lloyd's brokers will lead to market confusion at the consumer level. The brokers' concern has now been largely answered by Lloyd's confirmation that it intends to recommend the introduction of a byelaw, which will ensure that non-Lloyd's brokers who have access to the Lloyd's market are subject to the same prudential standards as Lloyd's brokers. This will ensure that they meet the standards necessary for dealing with the more complex kinds of business typically dealt with in the Lloyd's market. Permission to use the title "Lloyd's broker" will continue to be controlled by Lloyd's, and the Government does not therefore consider that the reform will lead to confusion.

5.40 A related argument was that removal of central control by Lloyd's would be less effective in terms of policing and maintaining standards than controls set in byelaw which would rely on the managing agents to do more themselves by way of due diligence. However, there is no reason why such controls should be less effective. Also, given that managing agents are already required to assess their sources of business and distribution mechanisms under FSA requirements (INSPRU 5.1.14), the change will build naturally and logically on existing practice. (One of the underwriting respondents noted that the change would in fact increase the value of the firm's existing internal counterparty management procedures.)

(iii) The reform will damage the special relationship between managing agents and Lloyd's brokers, which is complex, interdependent and mutually beneficial.

5.41 A further argument was that removing the Lloyd's brokers' special status would harm the special relationship that exists between managing agents and Lloyd's brokers. (This special relationship is illustrated, amongst other things, by the fact that Lloyd's brokers perform many administrative support services, reflecting Lloyd's-specific requirements, for managing agents.)

5.42 However, under the Government's proposals, there will still be the option for Lloyd's brokers to retain their current name, and if the brokers' services continue to add value, this will still be recognised. There is therefore no reason why this reform should affect relations where counterparty relations are strong. Managing agents also emphasised in consultation that they will continue as now to have responsibility for deciding which brokers they wish to deal with, and that they will want to maintain the key broker relationships they have already developed.

(iv) Longer-term, the reform may drive out the specialist brokers and begin to undermine the nature of Lloyd's as a subscription market.

5.43 In respect of the longer term, some Lloyd's brokers were concerned that this reform could drive out the specialist brokers who seek out high-value business from round the world; they also thought the changes could eventually change the character of the Lloyd's subscription market. However, the Government believes that specialist Lloyd's brokers will benefit from the repeal of section 8(3) as that section may obscure where any additional costs reflect the real value that they bring. The ending of a statutory limitation concerning broker access should therefore have no negative effect on specialist brokers or of itself lead to any undermining of the Lloyd's subscription market.

(v) Costing the proposal

5.44 Nearly all the brokers were concerned by the estimated cost savings from this proposal that were set out in the partial impact assessment to the consultation. Three of those who had expressed a neutral or positive position (including the LMBC) also objected to the costing. The Government has considered the arguments on the costing and has therefore revised the analysis.

5.45 The revised analysis is set out in the attached full impact assessment (Annex A). It takes account of the submissions made by brokers questioning the assumptions made in the partial impact assessment, and of the benefits Lloyd's brokers bring to the Lloyd's market. However, it also reflects the view, put by those in favour of the reform, that the repeal of section 8(3) should bring real benefits in the medium term, though the quantum of any immediate cost saving is hard to determine.

5.46 In conclusion, the Government believes that the proposals regarding section 8(3) continue to be justified and have the necessary support for inclusion in the draft Order. Repeal of the statutory restriction will enable Lloyd's to take forward work on its distribution strategy, consulting fully with all interests in the market. Lloyd's has committed to this process, and in fact several respondents who supported the reform (including members' agents, underwriters and the Institute of Insurance Brokers) positively looked forward to or requested further consultation.

PROPOSAL 8

Repeal the "divestment" provisions (Sections 10-12, Lloyd's Act 1982)

5.47 The second of the proposed market reform concerns the divestment provisions, which are closely linked with section 8(3). The provisions provide detailed rules prohibiting associations between Lloyd's brokers and managing agents, with the aim of preventing problems of conflicts of interests that potentially could affect policyholders, members and ultimately, the Lloyd's market.

5.48 These provisions were controversial when they were first introduced in 1982. (Prior to 1982, associations were permitted: however reform was felt essential at the time to respond to some of the very public conflicts of interest that had troubled the market in the late 1970s and early 1980s.) However, the Government considers that the situation in today's market is very different and that the rules are now an outdated and unnecessary burden. This is principally for two reasons.

5.49 The first reason is that the current rules are extremely complex and unwieldy. They impose compliance costs on managing agents and Lloyd's brokers, and on the

Society. At the same time, the rules do not achieve complete separation between brokers and managing agents as they do not prohibit all associations.

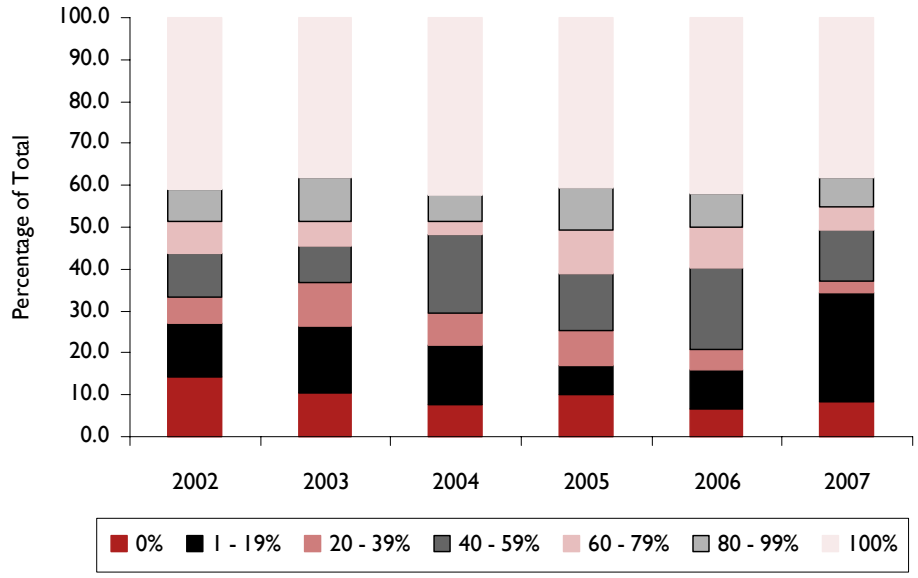
5.50 Second, in contrast to the situation in 1982, there is now independent regulation of conflicts of interest through the obligations the FSA places on firms through its Principles for Business and through special provisions for Lloyd's set out in INSPRU 8.2 (part of the FSA Handbook). These Principles are made under the FSA's rule-making authority under Part X of the Financial Services and Markets Act 2000 (FSMA) and apply both to businesses (including managing agents and brokers – whether Lloyd's brokers or not) and to persons who exercise controlled functions within the meaning of section 59 FSMA. The Principles include a requirement for firms to manage conflicts of interest fairly, and the FSA has confirmed that this includes conflicts of interest that affect members.

5.51 In addition, the Government is concerned that with the removal of section 8(3) of Lloyd's Act 1982, there will be a class of broker having access to the Lloyd's market which is not subject to these provisions, since the existing rules do not apply to brokers who are not Lloyd's brokers. However, there is no justification to subject Lloyd's brokers alone to the restrictions set out in these sections.

5.52 The Government therefore believes it would now be appropriate to remove these rules. However, because of the unique structure of the Lloyd's market (see below) the Government considers that some additional measure is needed to support the FSA's regulation of conflict of interest at Lloyd's, if the divestment provisions are removed.

Membership of Lloyd's syndicates (%)

Although the proportion of third party capital on Lloyd's syndicates has reduced since 1982, only around 40% of syndicates have fully aligned membership. (An aligned member is a corporate member of a syndicate that is directly or indirectly owned by the same firm that owns the managing agent of the syndicate.)



Source: Lloyd's

In consultation, the Government therefore proposed that if the divestment rules were removed a disclosure mechanism should be introduced, applying to managing agents, which would allow the Society and individual members of Lloyd's to monitor potential conflicts between managing agents and brokers and thereby help guard against systemic risks that might arise, for example, as the result of poor syndicate performance resulting from connected party business.

5.53 The aim of the new disclosure mechanism, as set out in the consultation document, would be to ensure both pre- and post- transaction transparency: the consultation document therefore proposed that under this mechanism managing agents would be required:

- to set out in each syndicate business plan submitted to the Franchise Board the parameters under which it will conduct business with any associated brokers; and
- to identify any associations they have with brokers and report regularly to the Society and to the members of their syndicates the proportion of business done with associated brokers.

Members agents would be required to ensure that these sections of the syndicate business plan, and any relevant changes to the syndicate business plan (e.g. if a new association with brokers was formed during the year) are brought to the attention of syndicate members.

5.54 The Government proposed that the new mechanism should be implemented by:

- provisions in byelaw, which would be subject to consultation by Lloyd's in accordance with FSA rules and then in turn reviewed by the FSA and
- new reporting obligations imposed under the Accounting Regulations that the Treasury is making to implement the Audit Directive (2006/43/EC) and the Reporting Directive (2006/46/EC)[17].

The consultation suggested that such a system would fit well with existing monitoring regimes run by the Society: it would provide a proportionate system to allow syndicate members and Lloyd's to monitor possible conflicts of interest and complement the FSA's existing role in this area.

AMENDMENTS PROPOSED: LRO ARTICLE 10

5.55 The proposal to repeal sections 10-12 of Lloyd's Act 1982 in favour of the introduction by Lloyd's of a new disclosure mechanism was welcomed by most respondents. During the consultation, however, a number of requests were made for greater clarity on the proposed disclosure mechanism. Lloyd's has, as a result, confirmed that the disclosure mechanism will include a requirement for managing agents to specify in their syndicate business plans information relating to associations or underwriting transactions which may give rise to a conflict of interest, and to make a statement confirming that they have systems and controls in place for dealing with related parties in order to ensure that any conflicts of interest are managed fairly in

[17] See Consultation on new Lloyd's Accounting Regulations: Implementation of the Audit Directive (2006/43/EC) and the Reporting Directive (2006/46/EC), published in April 2008.

accordance with applicable Lloyd's and FSA requirements. Lloyd's will introduce requirements as to the appropriate conflict management rules which must be adopted. Byelaws implementing these proposals will be subject to full consultation with the FSA and those who operate in the Lloyd's market.

5.56 In the light of this, the Government believes that repeal of the divestment provisions should form part of the draft Order. **The draft Order therefore repeals sections 10 to 12 of Lloyd's Act**.

REQUIREMENTS UNDER THE 2006 ACT

5.57 This provision is being made under section 1(1) of the Legislative and Regulatory Reform Act 2006.

How does the proposal remove or reduce burdens?

5.58 Sections 10 – 12 of Lloyd's Act 1982 impose burdens on managing agents, Lloyd's brokers (and in particular applicants to become Lloyd's brokers), and the Society itself. Managing agents are required to ensure that they do not enter into any prohibited associations with Lloyd's brokers. This affects their ability to enter into direct associations with Lloyd's brokers, and also restricts their choice of directors, which can give rise to administrative inconvenience. The same applies in relation to Lloyd's brokers. Applicants to become Lloyd's brokers have the choice of severing any existing associations they may have with managing agents, or engaging in corporate restructuring to ensure that they do not breach the prohibitions (it is possible for corporate structures to be set up which do not fall foul of the prohibitions in sections 10 and 11, by, for example, increasing the number of holding companies through which an interest in a managing agent is held). Either option will cause administrative inconvenience and financial costs (including, for example, the legal fees necessary to set in place the appropriate corporate structure). The Society incurs financial costs in having to review all applicants to become Lloyd's brokers to see if they satisfy the restrictions, and to monitor managing agents' and brokers' subsequent compliance with these provisions.

5.59 This proposal will remove these costs, by repealing the relevant provisions. Managing agents and brokers will need to ensure that they are operating appropriate systems to avoid and manage conflicts of interest, in order to comply with rules made by the FSA. However, this will not impose any additional costs on either managing agents or brokers, as they are subject to these requirements now.

Could the policy objective be secured by non-legislative means?

5.60 No. This proposal seeks to remove the overly restrictive provisions in sections 10 to 12 of Lloyd's Act 1982 to allow Lloyd's to institute new controls, which are more compatible with the current regulatory approach to managing conflicts of interest. This cannot be achieved without the repeal of the sections in question.

Is the provision proportionate, and fair?

5.61 Sections 10 to 12 of Lloyd's Act 1982 seek to prohibit any form of association between Lloyd's brokers and managing agents, in order to prevent any form of conflict of interest arising between brokers and managing agents. The complexity of the existing provisions adds significantly to the costs incurred by those seeking to become Lloyd's brokers or managing agents.

5.62 Although the sections aim to provide an exhaustive list of potential associations between brokers and agents to be prohibited, it is possible for corporate structures to be designed which do not fall within the precise terms of the sections. This means the rules are only effective in preventing the particular associations defined in the 1982 Act. Further it is not practicable to attempt to prohibit associations between managing agents and all insurance intermediaries. The sections therefore cannot provide any safeguard in relation to conflicts of interest which may arise from such associations once the restriction in section 8(3) is removed in line with proposal 7.

5.63 However, managing agents are already subject to regulation by the FSA, including its rules on the management of conflicts of interest. All businesses are required to manage conflicts of interest fairly under principle 8 of the FSA's Principles for Business[18]. Managing agents are required to establish and maintain adequate systems and controls to manage the risks to which their syndicate's insurance business is exposed, including in particular transactions which may give rise to a conflict of interest.

5.64 In addition, it is proposed that the existing regulatory framework will be supplemented by requirements for managing agents to disclose any associations they may have with intermediaries, and the amount of business done through associated intermediaries to ensure that the Society is able to monitor such associations and ensure that Names are fully informed of them. The Government considers that the effect of these proposals is proportionate to the policy objective, and that these proposals will not have any adverse effect on stakeholders or the general public.

Does the proposal remove any necessary protection, or prevent any person from continuing to exercise any right or freedom?

5.65 For the reasons set out above, the Government does not consider that this proposal will remove any necessary protection, or that they will prevent anyone from exercising an existing right or freedom.

CONSULTATION REACTION

5.66 Of the 45 respondents who considered this proposal, **40 (89%) were in favour, 1 (2%) expressed reservations and 4 (9%) were against**.

5.67 Of the 40 who welcomed this proposal, 15 offered more detailed comments, in particular:

- supporting the contention that the FSA's principles-based regulation of conflicts, properly applied, should provide a more effective protection for policyholders than the current divestment rules; and
- noting that conflict management would be further supported by other initiatives currently being run by the FSA, specifically the FSA's initiative on transparency (see the FSA discussion paper on transparency).

5.68 Two respondents recommended the introduction of more robust mechanisms outside the Act for managing conflicts of interest. One of these (a members' agent) provided a detailed submission requesting that this additional protection should take the form of a Lloyd's Code, to be required by the LRO and implemented in byelaw (including through amendment to the Syndicate Accounting Byelaw).

[18] See section PRIN 2.1 of the FSA Handbook, which can be found at http://fsahandbook.info/FSA/html/handbook/PRIN/2/1.

5.69 The Government does not consider it is necessary for the draft Order itself to provide a power to make a Code of Conduct and require compliance with it as suggested by the members' agent. Lloyd's already has power under section 6(2) of the 1982 Act to make provision for the management of conflicts of interest. Lloyd's intends to introduce requirements for the conflict management rules to be adopted for managing agents (see paragraph 5.55 above). There will be full consultation on the draft byelaw and requirements setting out these rules, at which point these proposals may be considered further.

5.70 Two other respondents also made strong objections to the proposed reform, one on the grounds that the proposal placed too much reliance on the FSA's capacity to monitor potential conflicts; and the other on the grounds that it was not an appropriate use of an LRO to repeal detailed provisions which had been the subject of considerable debate in Parliament when introduced in 1982.

5.71 The Government and the FSA are aware that under the new arrangements the FSA's existing scrutiny of the way in which the market is managing potential conflicts will extend to a wider range of potential conflicts. However, the requirements which are being introduced for disclosure in syndicate accounts and syndicate business plans will allow conflicts to be monitored by Lloyd's, syndicate members or their members' agents, and the FSA. Concerning the appropriateness of the reform, the 2006 Act allows the amendment of primary legislation which may have been subject to considerable debate when it was passed. The Government has given a commitment that the 2006 Act will not be used to implement highly controversial reforms. It does not believe, given the radically different regulatory environment existing now, that these reforms are highly controversial today, as the high level of support received by proposal 8 bears witness.

6 OTHER CONSULTATION RESPONSES

6.1 This Chapter deals with responses received to the consultation that contained suggested additions to the draft Order.

6.2 As noted in paragraph 3.12, twenty respondents suggested other reforms for inclusion in the draft Order.

6.3 Two respondents suggested that reform was needed in a number of areas to enhance transparency as to the liabilities and potential liabilities of different classes of members (including members of Lloyd's who have been allowed to resign), to improve protection for Names at Lloyd's, and to address the loss of representation by members who can no longer vote. It was also argued that the status of working members who have transferred their underwriting to corporate bodies should be clarified, and statutory authority should be given to the Central Fund.

6.4 These responses did not make detailed proposals for legislation to address their concerns, and in some cases recognised expressly that the issues being raised were too fundamental for inclusion in an order made under the 2006 Act. Instead, the concern appears to be that the proposals made in the draft Order were premature, and should not be advanced until after a thorough review of these issues. However, the Government remains of the view that the Lloyd's market will benefit from the provisions set out in the draft Order.

6.5 The other respondents did make more detailed proposals. The Government does not believe any of these proposals can be included in a Legislative Reform Order, either because they cannot be shown to remove or reduce a burden resulting from the legislation governing Lloyd's, or because they do not comply with the preconditions which must be satisfied under section 3 of the 2006 Act. The Government has not considered the merits of the suggested reforms. Each of the reforms suggested, and the Government's response, is set out below.

PROPOSED ADDITIONS THAT BUILD ON THE GOVERNMENT'S PROPOSALS

Eliminate the distinction between working and external members

6.6 An investment adviser suggested that, in the light of the proposal in the LRO to eliminate the need for the Chairman to be a working member, there was no longer any need to maintain the distinction between working and external members in elections to the Council. The investment adviser expressed the view that third party capital providers were all sophisticated private investors who no longer required separate representation and who should be able to vote for the professionals within the market who best represented their interests.

Government response

6.7 The Government does not consider that this proposal can be given effect in an Order under the 2006 Act. Under section 3(2), each constituency among Lloyd's members is entitled to separate representation on the Council, and members of one constituency can only vote for their own representatives, who must be members of that constituency. Removing the distinction between working members and external members for the purpose of elections to the Council, means that to be elected to

Council, a member would need to command the support of a majority of all members of Society, not simply of his or her own constituency. Where a particular constituency – like third party capital providers - is in a minority, they would not be able to ensure the election of a Council Member who would represent their interests on the Council. As section 3(2) currently stands, it appears to protect the rights of third party capital providers, and the Government considers that amending this provision as suggested could be said to remove a necessary protection. It would not therefore satisfy the preconditions set out in section 3(2) of the 2006 Act. Nor has it been shown how the existing provisions imposes a burden, within the meaning of section 1(3) of the 2006 Act, on either the Society or the members of Lloyd's.

Greater clarity on the Accountability of the Council of Lloyds

6.8 One respondent suggested that Lloyd's Act 1982 was unclear as to the identity of the persons to whom the Council of Lloyd's was accountable, and that the 1982 Act be amended to make it clear that the Council of Lloyd's should perform its duties in a manner which (a) properly recognises policyholders' interests and (b) is in the interests of the present members of Lloyd's.

Government response

6.9 Section 4 of Lloyd's Act 1911 provides, in substitution for section 10 of Lloyd's Act 1871, that the objects of the Society of Lloyd's include "the advancement and protection of the interests of Members of the Society in connection with the business carried on by them as Members of the Society". In addition, the preamble to the 1982 Act sets out the intention for the establishment of the Council:

> "It is expedient in order to enable the Society to regulate the management of its affairs in accordance with both present-day requirements and practice and the interests of Lloyd's policyholders that—
>
> (a) there should be established a Council of Lloyd's to have control over the management and regulation of the affairs of the Society."

6.10 As the governing body of the Society, the Council must act in accordance with the objects of the Society, in the interests of the Society's members. The preamble to Lloyd's Act 1982 makes it clear that the Council should also take account of the interests of policyholders. It appears therefore that these concerns are fully satisfied by the provisions of Lloyd's Acts 1871 to 1982 as currently in force.

Extend the definition of Underwriting Member

6.11 One respondent suggested that the definition of "underwriting member" contained in section 2(1) of the Lloyd's Act 1982 be amended to permit the inclusion of structures similar to the Insurance Special Purpose Vehicles (ISPV) recently proposed by the Financial Services Authority, in place of the Annual Venture. He expressed concern that the Reinsurance to Close (RITC) mechanism meant that syndicates were inhibited from adopting a broader or longer-term investment strategy, and were unable to build up reserves beyond their known or anticipated liabilities.

6.12 This respondent circulated his ideas widely amongst Lloyd's members and other interested parties. One of those responding to the consultation therefore submitted a counter argument, to the effect that the discipline of the Annual Venture remains essential, as long as there is any possibility that the liabilities of an underwriting venture at Lloyd's may need to be met from a Central Fund.

6.13 A related proposal was made by another respondent, who suggested that the requirement for all syndicates to perform a reinsurance to close operation (RITC) at the end of every year imposed an unnecessary burden on those syndicates which are fully aligned Integrated Lloyd's Vehicles (ILV) (whereby both a managing agency and a member of Lloyd's is owned by the same holding company) where the membership of the syndicate does not change from year to year. This respondent proposed that the 1982 Act be amended to remove this requirement for fully aligned ILVs.

Government response

6.14 The Government does not consider that it would be possible to give effect to the first proposal under the Legislative and Regulatory Reform Act 2006. The definition of "underwriting member" in s 2(1) of the Lloyd's Act 1982 is "a person admitted to the Society as an underwriting member". This gives Lloyd's considerable discretion in determining the sorts of entities that may be admitted as underwriting members. No provision in Lloyd's Act 1982 prevents Lloyd's from recognising a corporate body as both an underwriting agent, and as an underwriting member of Lloyd's. Accordingly, it cannot be said it is necessary to amend primary legislation to achieve the objective behind this proposal. The proposal does not therefore satisfy the preconditions in section 3 of the 2006 Act, and cannot be made by an order under that Act.

6.15 When the respondent concerned was informed of this, he submitted a further response withdrawing his proposal.

6.16 It is also not possible for an order under the 2006 Act to amend Lloyd's Act 1982 to relieve some syndicates from the requirement to perform a Reinsurance to Close at the end of every year. This requirement is not set out in the 1982 Act itself. It derives from byelaws and other rules made by Lloyd's. It can therefore be amended or removed by the Council of Lloyd's by amendment of the relevant provisions. It is not necessary for the 1982 Act to be amended. There is therefore a non-legislative means of giving effect to this proposal, which means that it cannot satisfy the preconditions set out in section 3(2)(a) of the 2006 Act, which must be met by all provision included in an order made under the 2006 Act.

PROPOSALS FROM A LLOYD'S NAME

6.17 The following four proposals were put forward by a Lloyd's Name. He spoke in favour of the proposals at the Extraordinary General Meeting of the Society on 21 May and urged fellow members of Lloyd's to write to the Treasury to add their support. A total of 10 did so. A members' agent also expressed support.

Approval of Lloyd's Byelaws

6.18 The first of these proposals was to advocate the reinstatement of a provision analogous to that previously contained in section 26 of the Lloyd's Act 1871. This had provided that byelaws made by the Society did not have effect until they were submitted to the Recorder of London and allowed by him as (a) not beyond the authority of the Society and (b) not repugnant to the law of England or any provision of the Lloyd's Act. The proposer suggested that the Recorder's role had provided an extra element of scrutiny for Lloyd's byelaws and that the Financial Services Authority would now be well suited to carry out this role, given their responsibility for Lloyd's under the Financial Services and Markets Act 2000 (FSMA).

Government response

6.19 As this proposal notes, the Financial Services Authority has responsibility for regulating Lloyd's under FSMA. In particular, under section 314 (1) of FSMA, the FSA has a duty to keep itself informed of the way in which the Council supervises and regulates the market at Lloyd's, and the way in which regulated activities are being carried on in that market. Under rules in the FSA handbook (at INSPRU 8.2.23 – 8.2.29), the Society must, as soon as it is practical to do so, notify the FSA of its intention to make any amendment that may alter the meaning or effect of any byelaw, and provide the FSA with full details of the amendments concerned. It is also required to consult interested parties in relation to any amendment. The information to be provided to the FSA by the Society must include a statement of the purpose of any proposed amendment and the expected impact, if any, on policyholders, managing agents, members and potential members; and a description of the consultation undertaken, including a summary of any significant responses to that consultation. The guidance given by the FSA states that it expects to receive the information Lloyd's must provide three months before any proposed change.

6.20 Under section 318 of FSMA, the FSA has wide-ranging powers to give directions to Lloyd's, including directions requiring Lloyd's to give effect to any objections it may have to proposed byelaws. In practice therefore, the FSA has already been given the role this amendment envisages, and it has the power to object to provisions in draft byelaws. The FSA's ability to use its existing powers to ensure that draft byelaws proposed by the Council of Lloyd's are policed means that it is not possible to say that there is no non-legislative means of giving effect to his proposal. The proposal would not therefore satisfy the precondition in section 3(2)(a) of the 2006 Act, and cannot be made by an order under that Act.

Promulgation of Lloyd's Byelaws

6.21 The second of these proposals was to suggest that section 12(4) of the Lloyd's Act 1911 ought to be amended to include an obligation on Lloyd's to inform Members directly of any proposed changes to byelaws that affect them. The proposal notes that section 12(4) of the 1911 Act obliged Lloyd's to disseminate information about proposed byelaws by means of posting a notice in the Room at 1 Lime Street, and suggested that this operated to the disadvantage of external members, who did not have access to the Room.

Government response

6.22 It is also not possible to give effect to this proposal in an order made under the 2006 Act. Section 12 of Lloyd's Act 1911 has already been repealed by section 15 of and schedule 3 to the 1982 Act. It was preserved in effect under transitional provisions in paragraph 11 of Schedule 4 of that Act until a Disciplinary Committee had been established by byelaws made under the 1982 Act. This was done in 1983, by the Disciplinary Committees Byelaw, and section 12(4) is no longer in force.

6.23 The more relevant provision in the 1911 Act is section 14 of that Act, which requires the Society to publish notices to members, including notices of any byelaws by posting them in the Room at Lloyd's "or in such other manner as may be prescribed by the byelaws of the Society". The Society is not therefore required to publish notice of byelaws only in the Room at Lloyd's. So far as the Lloyd's Acts are concerned, the Society is free to provide for an alternative means of consultation (though, as noted above, it is subject to FSA rules, which require consultation with interested parties). It

cannot therefore be said that any burden which may exist on members in consequence of the consultation methods followed by the Society results from the legislation which this proposal would like to amend. There is therefore no power to make the proposed amendment under the 2006 Act.

Compulsory Purchase of Syndicate Capacity

6.24 The third proposal was to suggest that a provision analogous to that contained in section 979(2) of the Companies Act 2006 should be included in Lloyd's Act 1982. Section 979(2) requires an acceptance level of 90% of the shares to which an offer relates before the offeror obtains the right of compulsory purchase from minority shareholders, and it was suggested that the same level of agreement ought to be required before a managing agent could compulsorily acquire syndicate capacity from a member.

6.25 In addition to the 10 members who supported these proposals in identical terms, similar proposals for the draft LRO to include provisions amending the Lloyd's rules on the compulsory purchase of syndicate capacity were submitted by 2 other members. Both call for Lloyd's rules to be brought into alignment with the provisions in the Companies Act on the purchase of minority shareholdings. One Name expresses particular concern at the way the Lloyd's rules allow the capacity held by a managing agent in parallel syndicates to be amalgamated for the calculation of the level of syndicate allocated capacity held by the managing agent, and members of the syndicate accepting his offer, which triggers the right of the managing agent to "buy-out" the capacity of the minority on the syndicate. Another notes that the byelaws and guidance notes governing this right can be varied by Lloyd's at its discretion.

Government response

6.26 The Government does not believe that it would be possible to make provision in an order made under the 2006 Act to amend Lloyd's rules in relation to minority buyouts. As noted above, the rules governing this right are set out in byelaws and guidance made by Lloyd's, and in particular in the Major Syndicate Transactions Byelaw, which was made in 1997. They are not contained in Lloyd's Act 1982. Amendment of the rules does not therefore require an amendment of the 1982 Act, and because the relevant provisions can be amended by byelaws made by the Council of Lloyd's there is a non-legislative means of giving effect to this proposal. Accordingly the proposed amendment would not satisfy the precondition in section 3(2)(a) of the 2006 Act, and it cannot therefore be included in an Order made under the 2006 Act.

Judicial Review of Lloyd's

6.27 The fourth proposal (which was also supported in two other responses made to the consultation) was to suggest that the Lloyd's Act ought to be amended to provide a statutory right to judicial review for Lloyd's members. In support of this it was argued that Parliament had only accepted the statutory immunity set out in Lloyd's Act 1982 on the basis that judicial review of Lloyd's would be available.

Government response

6.28 The burden which this proposal seeks to remove is not entirely clear. Section 14 of Lloyd's Act 1982 exempts the Society from liability in damages at the suit of a member of the Lloyd's community when it has, in good faith, exercised its discretion in connection with the running of the Lloyd's market. The Court of Appeal has recognised that, were the Society acting unlawfully in its regulatory functions, or in excess of its

powers or in bad faith, it could be restrained from doing so[19]. The unavailability of public law remedies given on judicial review applications to members does not result from the statutory immunity in section 14 of the 1982 Act. It is a consequence of a series of court decisions commencing with *R v Lloyd's of London ex p Briggs*[20] which have found that the relationships between Lloyd's and its members are founded in private law, not public law, and that Lloyd's, in relation to the cases which have so far come before the courts, has not been found to be exercising a public function. It does not therefore appear that this proposal can be said to remove a burden resulting from legislation, as required by the 2006 Act. It is therefore not possible for a provision giving effect to this proposal to be included in an Order made under that Act.

OTHER PROPOSED CHANGES

6.29 Two other changes were proposed concerning voting weights and the number of members needed to challenge a byelaw.

Number of Members needed to challenge a Byelaw

6.30 A further proposal made by the Name above, was that section 6(4) of Lloyd's Act 1982 should be amended so that, instead of requiring a notice in writing signed by 500 members of the Society before the Council is obliged to submit a byelaw or the revocation or amendment of a byelaw to the members of the Society in general meeting, it would only require a notice in writing signed by 50 members of the Society (given that the number of underwriting members has reduced to about a tenth of that in 1982, when the Act was passed).

Government response

6.31 The Government does not believe it has the power to make this amendment in an order under the 2006 Act. This proposal seeks to make it significantly easier for members who disagree with the provisions of a particular byelaw to require the Council to requisition a general meeting for this purpose. This could impose considerable potential financial costs on the Society of Lloyd's, both in terms of the external costs (which for the 2008 Extraordinary General Meeting were calculated by the Society at approximately £20,000), and in terms of the internal costs in management and staff time which must be dedicated to preparing for and attending the EGM. Even if it could be said that this proposal would remove or reduce a burden on the members of the Society (which is unclear), it would be at the cost of imposing a greater burden on the Society.

6.32 In addition, the conditions under which a general meeting shall be convened are subject to regulation by byelaws made by the Council of Lloyd's. The Council therefore has the power to create an additional right for members to requisition a general meeting on less stringent terms than those set out in section 6(4). For example, paragraph 3(1) of the Annual and Extraordinary General Meetings Byelaw provides that an EGM may be convened by a members' requisition. A members' requisition may be made not only in consequence of section 6(4) of the 1982 Act, but by:

> (a) a number of members amounting to "the greater of (a) members constituting at least 10% by number of the members of the Society and (b) 450" (paragraph 3(2)(a)(i) and 3(2A)); or

[19] *Society of Lloyd's v Clementson* [1995] CLC 117; *Society of Lloyd's v Tropp*, [2006] EWCA Civ 88.

[20] [1993] 1 Lloyd's Rep 176.

(b) "any number of members to which in the aggregate there is attributable at least 10% of Total Capacity" (paragraph 3(2)(a)(ii)).

6.33 As there is a non-legislative means of giving effect to the policy behind this amendment (to make it possible for a smaller number of members to requisition a general meeting at which a byelaw may be challenged), it does not satisfy the preconditions set out in paragraph 3(2)(a). It is not therefore possible for this proposal to be included in an order made under the 2006 Act.

Amendments to the Voting Weights

6.34 A respondent suggested that the weights given to members' votes at general meeting should be changed from "one man one vote" to reflect the contribution made by members of the market. The proposer suggested that this would be more equitable between members, would be closer to a normal company where shareholders' votes reflect the size of their shareholding, and would help increase the accountability of the Council of Lloyd's to those who fund it.

Government response

6.35 The only resolutions where all members have one vote on a ballot, regardless of the underwriting capacity they provide, are those proposed at general meetings convened under section 6(4) of Lloyd's Act 1982 on the requisition of 500 or more members of the Society to challenge a byelaw, or the amendment or revocation of a byelaw. All resolutions brought forward at other general meetings are decided, under 14(7) of the Annual and Extraordinary General Meetings Byelaw, by a ballot in which each member has one vote for every £500,000 or part of £500,000 of capacity attributable to that member. There have only been 2 meetings called under this provision since the 1982 Act was passed. In these circumstances, it appears doubtful whether the requirement in section 6(4) of the 1982 Act that resolutions to revoke a byelaw, or amendment of a byelaw, or to annul a revocation of a byelaw must be passed by a majority of the members voting in person or by proxy can be said to impose a burden on members within the meaning of section 1(3) of the 2006 Act.

6.36 In addition, this provision provides a safeguard for non-corporate external members of Lloyd's who provide a minority of the underwriting capacity for Lloyd's and who may therefore be outvoted by corporate members of Lloyd's if votes are only counted on a capacity basis, by ensuring that there is a mechanism available for them to challenge byelaws which are adverse to their interests. Changing the voting weight in relation to such resolutions to a capacity weighted basis would render this safeguard ineffective, and thus deprive non-corporate external members of a necessary protection, contrary to section 3(2)(d) of the 2006 Act.

6.37 The Government has therefore concluded that, even if this proposal could be said to reduce a burden, it does not satisfy the preconditions in section 3 of the 2006 Act, and cannot be included in an order made under the 2006 Act.

Scope of Lloyd's Statutory Immunity

Repeal of Section 14

6.38 The Names Action for Compensation and Defence in Europe (NACDE) and an underwriting member of Lloyd's argued that section 14 should be repealed. That section exempts the Society from liability in damages at the suit of a member of the Lloyd's community (which includes Lloyd's members, Lloyd's brokers and underwriting

agents) when it has, in good faith, exercised its discretion in connection with the running of the Lloyd's market. NACDE argued that this immunity is a contradiction to principles of corporate responsibility, which has created a culture at Lloyd's that believes itself to be outside the scope of ordinary law, giving members of the Council of Lloyd's greater protection than members of the Financial Services Authority.

Government response

6.39 It is not clear that the repeal of section 14 can be said to remove or reduce a burden. In addition, the Government is concerned that repealing section 14 would remove a necessary protection for the Society. The immunity granted to Lloyd's prevents the Society from being sued for damages in relation to the exercise or failure to exercise the powers, duties and functions granted to it by the Lloyd's Acts or regulations or byelaws made under those Acts. It fulfils an equivalent protective function to immunities granted to other bodies such as the Financial Services Authority (which has been granted exemption from damages under section 102 of the Financial Services and Markets Act 2000), and recognised investment exchanges and clearing houses (granted a similar exemption under section 291 of that Act). In the case of the Society, and recognised exchanges, Parliament has recognised that a limited immunity from suit serves the interests of ensuring that the markets in question are run effectively and efficiently, and that the bodies concerned are not deterred from properly policing those markets. Accordingly, a provision repealing section 14 would not satisfy the precondition in section 3(2)(d) of the 2006 Act, and cannot therefore be included in an order made under that Act.

Amendment of section 14.

6.40 The Cotesworth Action Group (representing a group of Lloyd's Names), suggested that section 14 of the Lloyd's Act 1982 be amended. The Cotesworth Action Group suggest that the Society should not be exempt from liability in damages relating to maladministration - "unreasonable, unfair, or unjust" acts - in connection with the Members' Compensation Scheme and that this amendment should be given retrospective effect.

Government response

6.41 The amendment proposed seeks to ensure that individual capital providers would be able to obtain compensation if they have suffered loss where they have made applications to the Members' Compensation Scheme, and those applications have been dealt with unreasonably, unjustly or unfairly, or in other words where there has been maladministration in the handling of the application.

6.42 It is not entirely clear how this amendment can be said to reduce or remove a burden within the meaning of section 1(3) of the 2006 Act. However, even if this is the case, there appear to be non-legislative means of securing this objective. The Government notes that, under the provisions of the Members' Ombudsman Byelaw, the members of the Society may complain to the Members' Ombudsman where they believe that they have suffered injustice in consequence of maladministration. The Ombudsman has substantial powers under that byelaw to investigate any complaint within his jurisdiction, and to make recommendations to facilitate the satisfaction, settlement or withdrawal of any complaint – including recommendations that ex gratia payments of money be made. As the Action Group note, the Ombudsman's powers are discretionary. However, this is a common feature of Ombudsman schemes (for example, the Parliamentary Commissioner for Administration has a discretion whether

to investigate claims made to him), and is not usually considered to detract from the effectiveness of the Ombudsman as a remedy for maladministration.

6.43 The amendment sought by the Action Group would expose the Society to the risk of legal proceedings in any case where a claim for compensation under the Membership Compensation Scheme had been rejected, whether or not there had been any maladministration. A claimant's allegation that the handling of his application to the Scheme was unreasonable, unfair or unjust would have to be tested before the Courts in each case. The Society would be required to devote significant resources (both in terms of costs and management time) to contesting such claims, even if the claim concerned was unfounded. Removing the protection section 14 provides to the Society against this, in a category of cases which, though limited, is acknowledged by the Action Group to be important, would still appear, contrary to the submissions of the Action Group, to contravene the condition in section 3(2)(d) of the 2006 Act. It is not therefore something which can be achieved by an order under that Act.

6.44 The Government is also concerned that the amendment proposed by the Action Group is intended to have retrospective effect in that it would apply in respect of claims which have already been submitted under the Scheme. It is a general principle, accepted by successive governments, that retrospective legislation should be avoided wherever possible. It has been recognised that there is a serious risk that legislating retrospectively will give rise to injustice. This is particularly the case where the effect of the legislation will be to expose a party to liability in relation to acts which would not have given rise to liability at the time when they took place. This appears to be the case here.

6.45 Retrospective legislation is inevitably controversial. Even if the amendment could otherwise be made in an order under the 2006 Act, the Government does not consider it would be appropriate for it to be given retrospective effect. However, an amendment without retrospective effect would necessarily fail to produce the result sought by Action Group.

6.46 In the light of these factors, the Government has concluded that it would not be appropriate to include this provision in the draft Order.

A Impact Assessment of the Legislative Reform (Lloyd's) Order

Impact Assessment of the Legislative Reform (Lloyd's) Order 2008

Summary: Intervention and Options

What is the problem under consideration? Why is Government intervention necessary?

The governance arrangements at Lloyd's, which are currently set out in Lloyd's Act 1982, are now outdated in a number of respects and contain restrictions that create barriers to further development of the Lloyd's market. Reform of the rules is necessary to remove these obstacles to improving the effectiveness and efficiency of the governance and market frameworks at Lloyd's.

What are the policy objectives and the intended effects?

The Government's aim is to support the market reforms being pursued by Lloyd's by amending the Act to remove or reduce burdens resulting from the existing governance arrangements. The reforms will improve the coherence and transparency of Lloyd's governance and administrative arrangements, which will help Lloyd's to maintain and improve its competitive position.

What policy options have been considered?

There are two main options:

1. Do nothing (this would require Lloyd's either to continue working within the constraints of the current rules or to introduce its own private Bill, which would potentially be a very time consuming and complex process) or

2. Use an LRO to modernise the rules, reduce administrative burdens and remove unnecessary restrictions on how Lloyd's organises its affairs.

Since there is a public interest in preserving the competitiveness of the UK's financial market, the Government believes it is appropriate to pursue a targeted set of reforms through an LRO. (See further discussion of this below.)

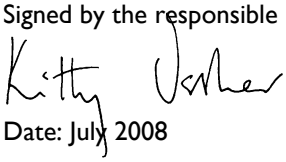
When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Government believes that a review would be best undertaken in 5 years time, since the impact especially of proposal 7 will not be clear before then.

Ministerial Sign-off

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



Date: July 2008

Summary: Analysis and Evidence

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition) **Yrs**	The proposals are deregulatory, and the package does not give rise to ongoing, additional overall costs. There will be costs associated with the new mechanism for monitoring conflicts of interest (proposal 8), but these will be minimal and more than offset by other savings and gains from the package.
£ De minimis	
Average Annual Cost (excluding one-off)	**Total Cost** (PV) **£ *De minimis***
£ De minimis	

Other **key non-monetised costs** by 'main affected groups'

N/A

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'
One-off **Yrs**	The main administrative savings arise from proposal 8. The biggest potential efficiency gains result from proposal 7.
£ De minimis	
Average Annual Benefit (excluding one-off)	**Total Benefit** (PV) **£ 200,000 from administrative savings. Efficiency gains, in particular from proposal 7, are not quantified.**
£ 23,000 from administrative savings. Efficiency gains, in particular from proposal 7, are not quantified.	

Other **key non-monetised benefits** by 'main affected groups'

The main non-monetised benefits are the efficiency gains from removal of the statutory restriction on Lloyd's distribution arrangements (proposal 7) and the outdated divestment provisions. There will also be more modest efficiency gains from the governance reforms.

Key assumptions/sensitivities, risks

The estimates for administrative savings are based on information provided by Lloyds. The main uncertainties relating to these stem from the extent to which these costs will decrease following the reform proposals. In relation to the efficiency gains, in the light of consultation, the Government is clear that the reforms, particularly from proposal 7, will bring important efficiency gains. However, these gains have proved difficult to quantify, so no figures are offered. The outturn here will depend on behavioural responses and a more accurate assessment could only be obtained over the medium term after the implementation of the reforms.

Price Base Year 2008	Time Period Years 10	**Net Benefit Range** (NPV) £ 40,000 – 500,000 (admin) Efficiency gains are not quantified	**NET BENEFIT** (NPV Best estimate) £ 200,000 (admin) Efficiency gains are not quantified

What is the geographic coverage of the policy?	The proposals will be implemented in the UK.
On what date will the policy be implemented?	When the LRO comes into force.
Which organisation(s) will enforce the policy?	Lloyd's and the Financial Services Authority.
What is the total annual cost of enforcement for these organisations?	There will be enforcement costs (for Lloyd's and the FSA) from the ongoing monitoring regarding conflicts of interest, but these will be minimal.
Does enforcement comply with the Hampton principles?	Yes.
Will implementation go beyond minimum EU requirements?	No.
What is the value of the proposed offsetting measure per year?	None.
What is the value of changes in greenhouse gas emissions?	None
Will the proposal have a significant impact on competition?	There is no adverse effect on competition. The proposals affecting brokers will help increase competition (see further discussion at A.23ff).

Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Costings not calculated on this format				

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

No impact on Government admin burdens baseline

Key: Annual costs and benefits: Constant Prices | (Net) Present Value

EVIDENCE BASE

Policy background

A.1 The aim of the draft Order is to modernise the governance arrangements at Lloyd's and remove administrative burdens and obstacles to the way Lloyd's organises its business affairs. To that end the draft Order includes six governance reforms, and two market-related reforms. The governance reforms will:

- provide more flexibility in arrangements for electing the Chairman and Deputy Chairmen of Lloyd's and in the rules governing elections to Council;
- remove outdated rules and structures and provide more transparent and streamlined rules for delegation by the Council of non-reserved powers; and
- remove administrative burdens regarding approval processes and the selection of individuals to serve on Disciplinary Committees.

These reforms will allow Lloyd's to align its governance practices more closely to the Combined Code on Corporate Governance.

A.2 As regards the market, the draft Order will remove the statutory restriction on Lloyd's distribution arrangements at section 8(3) Lloyd's Act 1982 (proposal 7). This will give Lloyd's greater flexibility in its distribution strategy and allow for increased competition, which should bring potential benefits to policyholders and the market as a whole. The draft Order will also remove outdated restrictions on associations between brokers and managing agents.

A.3 These changes are necessary in order to ensure that Lloyd's continues to be able to maintain its competitive position in the global marketplace. Although it would be possible for Lloyd's to seek amendments to the Act by sponsoring a private Bill, this would be potentially a time-consuming and complex process, since in contrast to an LRO, a Bill is more open-ended.

A.4 The Government believes that modernisation of the London insurance market generally and improvements in efficiency are key challenges in preserving the competitive position of the UK financial markets. For this reason, it is appropriate to use an LRO to deliver a package of practical reforms in a timely way to help the Lloyd's market.

A.5 The reforms have been subject to extensive consultation and generally welcomed, with clear majorities of support for all the reforms.

COSTS AND BENEFITS

A.6 In consultation, the Treasury provided some initial estimates of administrative and efficiency savings that could be expected in the light of the proposed reforms. There was no comment or further feedback on the estimates for administrative savings, so these are reproduced here. On the market reforms, feedback confirmed the view that these reforms should bring valuable benefits; however, it was felt these benefits would be difficult to quantify. Lloyd's brokers were also critical of the basis for calculating savings from the placement chain. In the light of this feedback, the Government is not offering any specific estimate for efficiency savings (particularly for this reform).

Administrative savings: summary

A.7 In consultation, the Treasury estimated the main administrative savings that could be expected from the reforms: these were in relation to:

- proposal 5 – an **annual saving of £3,000** (central estimate) – a figure derived from the estimated cost to Lloyd's of legal advice interpreting the current delegation provisions, annualised according to the number of such consultations sought by Lloyd's since 1982; and
- proposal 8 – an **annual saving of £20,000** (central estimate) – a figure derived from the cost to Lloyd's legal department of checking compliance with existing rules and for obtaining advice from Leading Counsel on the interpretation of the divestment provisions, again annualised according to the advice /number of consultations sought by Lloyd's since 1982. This figure includes an offset to take account of the compliance costs that will be associated with the new disclosure regime.

A.8 The Government has not attempted to quantify the administrative savings to managing agents and brokers as a result of the removal of the divestment provisions.

For managing agents, the proposed system for providing pre-transaction transparency on relationships with associated brokers should build on existing requirements and therefore only involve incremental additional compliance work. Similarly, the process of providing post-transaction reporting to members and the public should be achieved with no additional extra cost, since the aim is to utilise existing mechanisms to ensure transparency of information to members and to the public. As far as the FSA is concerned, the new monitoring mechanism will involve additional costs: however, these are likely to be negligible.

A.9 The consultation confirmed that the administrative savings for the Bank of England and Lloyd's from proposals 3 and 4 would be expected to be de minimis in monetary terms and were therefore not quantified.

A.10 For proposal 7, the partial impact assessment noted that under the proposed reform, Lloyd's will need to maintain arrangements for granting permission to use the title of Lloyd's broker (albeit ones that are smaller and more focused). Consultation feedback indicated that there could be some debate in future as to how that might be funded (currently the cost is part of the overhead paid to Lloyd's by members[21]); but in the absence of any decisions on this, the Government believes no allowance for administrative savings should be made in relation to proposal 7.

A.11 As no comment was received on these estimates, there is therefore no change in the figures presented in the final impact assessment for administrative savings.

Efficiency savings and the market reforms

A.12 In consultation, the Treasury indicated that efficiency savings could be expected from the proposed governance reforms (1,2, 5 and 6) and also both the market reforms (proposals 7 and 8). The Treasury did not attempt to quantify the efficiency savings from proposals 1,2, 5, 6 and 8; however, for proposal 7 (removal of the Lloyd's broker restriction) the Treasury initially offered an estimate, suggesting an annual saving in the range of zero-£200mn (with central estimate of £100mn). The consultation document stressed that this estimate was very sensitive to assumptions and a more accurate assessment could only be provided 2-3 years after the reform had been passed.

A.13 The estimates provided by the Treasury were criticised by Lloyd's brokers[22] and the one other response that objected to this proposal. In particular, it was felt that the estimates were misleading and that it simply would not be possible for the market to carry such high "unnecessary costs". The brokers disagreed with the assumptions made, and felt that the costs should be better balanced with an assessment of the value that brokers bring. In summary, the brokers' key concerns were that costings:

- included no recognition of the important role that wholesale brokers play in sourcing business and arranging for cover of complex risk;
- ignored the possibility that that costs would be transferred or absorbed in increased costs either by the originating broker or by the market;
- did not make allowance for the fact that a significant volume of Lloyd's premium flow (estimated at 60% of the whole) came from vertically

[21] As confirmed by one respondent to the consultation.

[22] Including all six brokers who objected to the proposal as well as 3 who took a neutral stance on the proposal or supported it.

integrated brokers, whose costs were (in the brokers' view) a wholly internal matter;

- over-generalised from the experience of the US property and casualty sector;
- failed to take account of increased costs that managing agents might have, in dealing with a wider broker network.

A.14 The brokers also argued that since Lloyd's had now confirmed it was intending to recommend to Council a byelaw to set the same prudential standards for all brokers, all references to potential administrative savings[23] should be removed from the assessment of the proposal.

A.15 In the light of these criticisms, the Treasury discussed the estimates with Lloyd's and the LMBC. This discussion underlined the difficulties of identifying appropriate metrics and the sensitivity of the estimates to assumptions (as had been acknowledged in the consultation document). This means there is no settled evidence, which can be agreed for an estimate of potential cost savings.

A.16 Many of the commentators who supported the proposal, however, felt it was right to expect cost savings and other benefits (such as increased business), certainly in the longer term. Some of these, while expecting cost savings, thought it was difficult to predict where the savings would come from, or how the savings could be quantified. This is illustrated by the following sample of views:-

> "Opening up the market can only benefit all parties and the likely result is that more business will ultimately be placed at Lloyd's" – *City institution*

> "…a clear lesson of the **general process of financial market liberalization since the 1980s** is that increasing competition and transparency in intermediation (which Lloyd's is also rightly pursuing in broking as a major policy goal) bring substantial benefits. Indeed, an analogous process is now taking place in securities trading generally, in particular in the EU, not least thanks to MiFID. Such liberalisation both reduces the cost of intermediation and increases the quality of service to investors and capital issuers. **These are strong grounds for expecting similar deregulatory benefits in the Lloyd's case**." – *Lloyd's Name*

> In the short term it will result in only small administrative savings, but in the long term may lead to more innovative relationships with brokers based both in London and around the world" – *Corporate member*

A.17 These responses reinforce the Government's view that opening up access to Lloyd's will produce efficiency savings and other benefits for the market. Equally, because of the uncertainties stressed by respondents, it seems there is insufficient evidence to give any particular estimate for the overall expected efficiency saving from the reform. **The Government is therefore not offering a monetised estimate for the efficiency savings and potential benefits from this reform**.

A.18 As stated in the consultation document, the final savings will not be able to be assessed with greater accuracy until several years after the reform.

[23] The partial impact assessment in fact made no attempt to quantify administrative savings from the removal of section 8(3).

A.19 In the Government's view, the removal of the statutory restriction by proposal 7 will not adversely affect the real value-added business done by wholesale brokers, since this will continue to be recognised and rewarded. Although there will be increased competition, competition is already a factor for brokers and many have already diversified or developed new business leads in response. In addition, removal of the divestment provisions will open up new opportunities for brokers, and allow brokers to consider strategic associations with managing agencies, based on their own individual business strategy.

OTHER ISSUES

Issues of equity and fairness

A.20 The Government considers that these proposals will not bring disproportionate benefits or have a disproportionate effect on any particular groups.

Small firms impact test

A.21 The Government considers that the proposals will not have any significant impact on small firms.

Human Rights

A.22 As set out in the Explanatory Document, the Government considers that the proposals are compatible with the Convention rights protected under the Human Rights Act 1998.

Competition assessment

A.23 Application of the competition filter test shows that the proposed reforms will not have a material adverse effect on competition. The competition filter test is carried out by examining whether the regulation (i) directly or indirectly limit the number or range of suppliers, or (ii) limit the ability, or reduce the incentives, of suppliers to compete.

A.24 The governance reforms (proposals 1-6) are not deemed to have any adverse effect on competition; they solely relate to Lloyd's governance arrangements, and do not impact on the market structure.

A.25 The removal of section 8(3) (proposal 7) will allow for greater competition (both from non-Lloyd's brokers, and, where this develops, through new methods of direct access to the market). As responses to the consultation noted, this reform will therefore promote efficiency savings and encourage innovation, which will benefit policyholders and the market as a whole.

A.26 The removal of the divestment provisions (proposal 8) will open up new opportunities for managing agents and brokers, allowing them to consider strategic associations, based on their own individual business strategy. However the proposed mechanism for managing conflicts of interest will ensure there are no adverse effects on the market as regards conflicts of interest. The fact that both brokers and managing agents will be able to consider reciprocal diversification strategies will also help ensure that the removal of the provisions has no adverse effects on competition.

Enforcement, sanctions and monitoring

A.27 As these changes constitute amendments to the statute governing Lloyd's, Lloyd's will be responsible under the Act (as amended by the LRO) for ensuring their appropriate implementation. The FSA will continue, in accordance with its principles for businesses, to review in a risk-based manner the arrangements that firms have in place to identify, manage fairly and where appropriate, mitigate actual or potential conflicts of interest.

A.28 The Government believes that a review would be best undertaken in 5 years time, since the impact especially of proposal 7 will not be clear before then.

Specific Impacts Checklist

The table below confirms which specific impact tests have been considered for this consultation.

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	Yes	No
Rural Proofing	No	No

B List of consultees

Lloyd's of London

Lloyd's of London and its members

Association of Lloyd's Members
High Premium Group

Lloyd's market participants (see below p66)

Lloyd's managing agents
Lloyd's brokers
Lloyd's members agents

Industry/Trade Associations

Association of British Insurers
Association of Investment Companies
Association of Private Clients Investment Managers and Stockbrokers
British Bankers Association
Chartered Insurance Institute
City of London Law Society
Confederation of British Industry
Federation of Small Business
Financial Markets Law Committee
Institute of Insurance Brokers
Insurance Institute of London
International Underwriting Association of London
International Union of Aviation Insurers
Investment Management Association
Law Society of England and Wales
Law Society of Scotland
Law Society of Northern Ireland
Lloyd's Market Association
London Market Insurance Brokers' Committee
London Investment Bankers Association
London Stock Exchange

Other Government Departments/Public Sector

Bank of England
Cabinet Office
Department of Business, Enterprise and Regulatory Reform
HMRC
Financial Services Authority
Welsh Assembly Government
Scottish Executive
Small Business Service

Individuals

Christopher Stockwell (NACDE)
Leon Metcalfe (Cotesworth Action Group)
D W Mann
Julian West

Full list of brokers, managing agents and members' agents/ advisers consulted

Lloyd's managing agents

ACE Underwriting Agencies Ltd
Advent Underwriting Ltd
AEGIS Managing Agency Ltd
Amlin plc
Argenta Syndicate Management Ltd
Ark Syndicate Management Ltd
Ascot Underwriting Ltd
Atrium Underwriters Ltd
Beaufort Underwriting Agency Ltd
Beazley Furlonge Ltd
Brit Insurance Holdings plc
Broadgate Underwriting Ltd
Cathedral Underwriting Ltd
Catlin Underwriting Agencies Ltd
Canopius Managing Agents Ltd
Chaucer Holdings PLC
CMGL Syndicate Management Ltd
Diagonal Underwriting Agency Ltd

Equity Syndicate Management Ltd
Faraday Underwriting Limited
Hardy (Underwriting Agencies) Ltd
HCC Underwriting Agency Ltd
Heritage Managing Agency Ltd
Hiscox Syndicates Ltd
Imagine Syndicate Management Ltd
Jubilee Managing Agency Ltd
K.G.M. Underwriting Agencies Ltd
Liberty Syndicate Management Ltd
Managing Agency Partners Ltd
Markel Syndicate Management Ltd
Marketform Managing Agency Ltd
Marlborough Underwriting Agency Ltd
Mitsui Sumitomo Insurance Underwriting at Lloyd's Ltd
Munich Re Underwriting Ltd
Navigators Underwriting Agency Ltd
Newline Underwriting Management Ltd
Novae Syndicates Ltd
Omega Underwriting Agents Ltd
Pembroke Managing Agency Ltd
QBE Underwriting Ltd
RITC Syndicate Management Ltd
RJ Kiln & Co Ltd
S.A. Meacock & Company Ltd
Sagicor at Lloyd's Ltd
Spectrum Syndicate Management Ltd
Starr Managing Agents Ltd
Talbot Underwriting Ltd
Travelers Syndicate Management Ltd
XL London Market Ltd

Lloyd's brokers

AAA Insurance & Reinsurance Brokers Ltd
Alec Finch (London) Ltd
Alsford Page & Gems Ltd
Alston Gayler & Co Ltd
Alwen Hough Johnson Ltd
Anglo French (UK) Ltd
Aon Ltd
Aon Re Italia Srl
ARB International Ltd

Arthur J Gallagher (UK) Ltd
Bannerman Rendell Ltd
BDB Ltd
Beach & Associates Ltd
Bell & Clements Ltd
Benfield Asia Pte Ltd
Benfield Group
Benfield Paris
Bennett Gould & Partners Ltd
Berry Palmer & Lyle Ltd
Besso Ltd
BISYS Hanleigh
Blackmore Borley Ltd
Bloemers & Partners Ltd
BMS Group Ltd
Bowood Partners Ltd
Broker Network London Markets
Butcher Robinson & Staples International Ltd
Butcher Robinson & Staples Marine Ltd
Camberford Law Plc
Carroll & Partners Ltd
CBC UK Ltd
Chesterfield Insurance Brokers Ltd
CityNet Insurance Brokers Ltd
CJ Coleman & Co Ltd
CKRe Ltd
Clegg Gifford & Company Ltd
COBRA London Markets Ltd
Cogent Resources Ltd
Colemont Insurance Brokers Ltd
Conner Hale Kerslake Ltd
Contractsure Ltd
Cooper Gay & Co Ltd
Corrie Bauckham Batts Ltd
COSCO (Hon Kong) Insurance Brokers Ltd
Cosmos Risk Solutions Ltd
Craven Partners Ltd
Crescent Global Services UK Ltd
Crest Underwriting Ltd
Crispin Speers & Partners Ltd
Dashwood Brewer & Phipps Ltd
Dublon Insurance Brokers Ltd
Elliott Special Risks Ltd

Endeavour Insurance Services Ltd
EPG Insurance Services Ltd
European Brokers Associated Ltd
Execution Ltd
FirstCity Partnership Ltd
FP Marine Risks Ltd
Gallagher Re (UK)
Genavco Insurance Ltd
Giles Insurance Brokers Ltd
Gina Fitzgerald Ltd
Glencairn Ltd
Gresham Insurance Brokers Ltd
Griffiths & Armour Global Risks Ltd
Grimme Butcher Jones Ltd
Grosvenor Brokers (America) LLC
Group Eyssautier
Guest Krieger Ltd
HW Wood Ltd
Harman Kemp North America Ltd
Harman Wicks & Swayne International Ltd
Harman Wicks & Swayne Ltd
Hayward Aviation Ltd
HBA Ltd
Heath Lambert Ltd
Hispania Risk Broker Correduria de Seguros y Reaseguros S.A.
Houlder Insurance Services Ltd
Howard Global Insurance Services Ltd
Howden Insurance Brokers Ltd
HRH Reinsurance Brokers Ltd
HSBC Insurance Brokers Ltd
Insurance Marketing Ltd
Integro Insurance Brokers Ltd
International Professional Risks Ltd
International Risk Solutions Ltd
Iris Insurance Brokers Ltd
James Hampden Insurance Brokers Ltd
Jardine Lloyd Thompson Ltd
Jardine Lloyd Thompson UK Ltd
JB Boda & Co (UK) Ltd
JIS (Chile) Ltd
JLT Reinsurance Brokers Ltd
John B Collins Associates (UK) Ltd
John Holman & Sons Ltd

K M Dastur & Company Ltd
Kerry Lonsdale Ltd
Kinetic Insurance Brokers Ltd
Kite Warren & Wilson Ltd
LIBG Ltd
Lloyd & Partners Ltd
Lockton Companies International Ltd
London Market Insurance Brokers Ltd
London Special Risks Ltd
Lothbury UK Ltd
LPH Pittman Ltd
Lucas Fettes & Partners (London) Ltd
Mar Risk Services Ltd
Marine Aviation & General (London) Ltd
Market Insurance Brokers Ltd
Marsh Ltd
Meridian Risk Solutions Ltd
Miles Smith Broking Ltd
Miller Insurance Services Ltd
N.I.B. (UK) Ltd
Nausch, Hogan & Murray (UK)
NCG Professional Risks Ltd
Newman Martin and Buchan Ltd
Norman Butcher and Jones Ltd
OAMPS Insurance Brokers Ltd
Oval International Ltd
Oxygen Insurance Brokers Ltd
Paragon International Insurance Brokers Ltd
Pareo Ltd
Parker Norfolk & Partners Ltd
Paul Napier Ltd
Platus
Price Forbes & Partners Ltd
Priest & Co Ltd
Primary Group Intermediary Services Ltd
PYV Ltd
Ramon International Insurance Brokers Ltd
Rasini Vigano Ltd
Rattner Mackenzie Ltd
RFIB Group Ltd
RIB Reinsurance International Brokers Spa
RK Carvill & Co Ltd
RK Harrison Insurance Brokers Ltd

RL Davison & Co Ltd
Robertson Taylor Insurance Brokers Ltd
Ropner Insurance Services Ltd
Safeonline LLP
SBJ Ltd
Seascope Insurance Services Ltd
Senior Wright Ltd
Smith Bilbrough & Co Ltd
Somerville Market Solutions Ltd
Special Contingency Risks Ltd
Special Risks Insurance Brokers Ltd
SSL Insurance Brokers Ltd
Stow & Croton Ltd
Strategic Insurance Services Ltd
Swinglehurst Ltd
Tasker & Partners Ltd
Texel Finance Ltd
Thompson Heath & Bond Ltd
Towergate London Market Ltd
Towers Perrin Claytons
Tyser & Co Ltd
United Insurance Brokers Ltd
W Denis Insurance Brokers Plc
Walsham Brothers & Co Ltd
WBA Srl
Willis Ltd
Windsor Partners Ltd
Windsor Professional Indemnity Ltd
Woodgate & Partners Ltd
WT Butler & Co Ltd

Lloyd's Members Agents/Advisers

Alpha Insurance Analysts Ltd
Argenta Private Capital Ltd
Hampden Agencies Ltd
Lloyd's Members Agency Services
Newton Follis Partners

C List of respondents to the consultation

The following bodies and individuals submitted written responses to the consultation.

Society of Lloyd's

Lloyd's individual members

Anthony Cooke
David Coke-Steel
Robert Hadfield
Eileen Hunter
Marcus Johnson
Alan Lane
Patrick Langdown
Walter Marais
Stephen Merrett
Leon Metcalfe (Cotesworth Action Group)
John Morris
O C Penge
David Peterman
CCH Picton
B D Price
Sir Adam Ridley
John Rimer
Christopher Stockwell (NACDE)
Dr Edwin Watson
John Waterstone
Dr Julian West

Association of Lloyd's Members

Lloyd's market participants (including corporate members, members agents, managing agents, brokers and advisers)

ACE European Group
Alpha Insurance Analysts
Amlin plc
Aon Ltd
Argenta Private Capital Ltd
Artannes Capital Ltd
Aviva plc
Beaufort Underwriting Agency

BMS Group Ltd
Bowood Partners Ltd
Brit Syndicates
Butcher, Robinson & Staples International Ltd
Catlin Underwriting Agencies Ltd
Griffiths & Armour
Hampden Agencies Ltd
Hiscox plc
Holmans Ltd
Lloyd's Market Association
London Market Insurance Brokers' Committee
Lockton Companies International Ltd
Price Forbes & Partners Ltd
Talbot Underwriting Ltd
Traveller's Syndicate Management
Willis Ltd

Industry/Trade Associations

Barclays
CITI
City of London Law Society
Clifford Chance
Corporation of London
Deloitte and Touche
Institute of Insurance Brokers
Instituto Nacional de Seguros
KPMG LLP
LIFFE
London Stock Exchange
Lloyd's TSB
Norton Rose
PricewaterhouseCoopers LLP
Royal Bank of Scotland

Individuals

Sir Peter Miller
Richard Southwell QC
Michael Wade
Sir David Walker

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