



House of Commons
Regulatory Reform Committee

Draft Legislative Reform (Lloyd's) Order 2008

Sixth Report of Session 2007–08

*Report, together with formal minutes and
written evidence*

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The Regulatory Reform Committee

The Regulatory Reform Committee (previously the Deregulation and Regulatory Reform Committee) is appointed to consider and report to the House on draft Legislative Reform Orders under the Legislative and Regulatory Reform Act 2006. Its full remit is set out in S.O. No. 141, which were approved on 4 July 2007.

Current membership

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Criteria against which the Committee considers each draft legislative reform order

Paragraph (3) of Standing Order No.141 requires us to consider any draft legislative reform order against the following criteria:

... whether the draft legislative reform order —

- (a) appears to make an inappropriate use of delegated legislation;
- (b) serves the purpose of removing or reducing a burden, or the overall burdens, resulting directly or indirectly for any person from any legislation (in respect of a draft Order under section 1 of the Act);
- (c) serves the purpose of securing that regulatory functions are exercised so as to comply with the regulatory principles, as set out in section 2(3) of the Act (in respect of a draft Order under section 2 of the Act);
- (d) secures a policy objective which could not be satisfactorily secured by non-legislative means;
- (e) has an effect which is proportionate to the policy objective;
- (f) strikes a fair balance between the public interest and the interests of any person adversely affected by it;
- (g) does not remove any necessary protection;
- (h) does not prevent any person from continuing to exercise any right or freedom which that person might reasonably expect to continue to exercise;
- (i) is not of constitutional significance;
- (j) makes the law more accessible or more easily understood (in the case of provisions restating enactments);
- (k) has been the subject of, and takes appropriate account of, adequate consultation;
- (l) gives rise to an issue under such criteria for consideration of statutory instruments laid down in paragraph (1) of Standing Order No 151 (Statutory Instruments (Joint Committee)) as are relevant;
- (m) appears to be incompatible with any obligation resulting from membership of the European Union.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at www.parliament.uk/regrefcom. A list of Reports of the Committee in the present Session of Parliament is at the back of this volume.

Committee staff

The current staff of the Committee are John Whatley (Clerk), Neil Caulfield (Inquiry Manager) and Liz Booth (Secretary/Committee Assistant).

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Summary

The draft Legislative Reform (Lloyd's) Order 2008 was laid before Parliament on 17 July 2008. The draft Order proposes a number of reforms in the governance of Lloyd's together with changes in certain restrictions on the operation of the Lloyd's insurance market. HM Treasury has recommended that the draft Order be proceeded with under the affirmative resolution procedure.

The timing with which this particular Order falls for our consideration is noteworthy in that the regulation of financial bodies is currently a matter of extensive discussion. Our assessment of the Order is based entirely on the merits of the proposed six governance reforms and two market-related reforms contained therein. These are specific to Lloyd's and have no direct connection with present conditions in financial markets. Should any draft legislative reform orders designed to improve the regulation of financial bodies be laid, we would, of course, deal with them expeditiously.

We have considered the relevant tests in the Legislative and Regulatory Reform Act 2006 and have carefully reviewed the consultation documents and submissions relating to the proposal. On balance, we believe that the proposed reforms will be beneficial and that the proposed replacement regulatory safeguards are adequate. The governance reforms are consistent with moves toward better governance and are balanced with appropriate safeguards. Of the two market reforms, we welcome the replacement of the divestment provisions, which can be circumvented, with better forms of safeguard, subject to there being early review of the effectiveness of the replacement safeguards. The other market reform—removal of the monopoly of Lloyd's brokers on broking business—is a deregulation measure that received a majority of support during consultation, including from the body representing Lloyd's brokers themselves.

We therefore agree that the affirmative resolution procedure is appropriate and recommend that the draft Order be approved.

1 Introduction

1. The draft Legislative Reform (Lloyd's) Order 2008 and Explanatory Document (ED) were laid before Parliament on 17 July 2008 under section 14(1) of the Legislative and Regulatory Reform Act 2006 (LRRRA). Pursuant to section 1 of the LRRRA, which grants power to remove and reduce burdens, the draft Order proposes a total of eight reforms to the operation of Lloyd's: six concerning Lloyd's governance and two removing or replacing restrictions on the working of the Lloyd's market. We put a number of questions about the draft Order to the Treasury in correspondence, the contents of which are annexed to this report. Because the proposed governance changes include changes to matters such as the term of office of the Chairman and Deputy Chairmen, they may be better understood in the light of the overview of current arrangements contained in the following section.

2 Background

Governance of Lloyd's

The Origins of the Lloyd's Committee and the Lloyd's Council

2. The first statutory constitution for Lloyd's was established by the Lloyd's Act 1871. Under that Act, the organisation was managed by a Committee of Lloyd's members subject to the control of the members in general meeting, who retained the power to make byelaws. A number of further Lloyd's Acts followed, but by the time of the Lloyd's Act 1982 ("the 1982 Act") making byelaws in general meetings was no longer deemed practical. The 1982 Act therefore established a Council of Lloyd's with power to make byelaws.¹

The Council

3. Unlike the Committee, which could consist only of Lloyd's working members, the 1982 Act provided for there to be three types of Council member:²

- a) Council members drawn from Lloyd's working members (working members being members of Lloyd's who occupy themselves principally with the conduct of business at Lloyd's by a Lloyd's broker or underwriting agent, or retired members of Lloyd's who were so occupied immediately before retirement);³
- b) Council members drawn from Lloyd's external members (external members being members in the sense of providing capital, who are not, however, working members; they include corporate members);

1 The 1982 Act did not abolish the Committee, however, and the Committee's existence and membership were restated by section 5 of that Act. Section 5 provides that the Committee is made up of the working members on the Council.

2 See 1982 Act, section 3(2)

3 See 1982 Act, section 2(1)

c) Nominated members (akin to independent, non-executive directors in that they must not be Lloyd's members; nominations are processed through the Lloyd's Nominations, Appointment and Compensation Committee which approves a short list prior to interview of candidates and Council voting).

4. The 1982 Act gave the Council power to change the numbers of members in each category of membership.⁴ The Council now consists of a maximum of 18 members—six in each of the three categories of “working”, “external” and “nominated”.⁵

Electing the Council, the Chairman and the Deputy Chairmen; Corporate Members

5. The working members on the Council are elected from among all the working members by vote of those members, and the same principle applies to election of the external members. Working members are elected on a one member, one vote basis.⁶ Voting rights in elections for external members are based on the amount of underwriting capacity attributable to the voting member.⁷ Nominated members are appointed by the Council by special resolution.⁸ At present, their appointment is subject to confirmation by the Governor of the Bank of England.⁹

6. Under section 4 of the 1982 Act, the Council must currently conduct an annual election for a Chairman, together with two or more Deputy Chairmen. The same section provides that the Chairmen and Deputy Chairmen must be chosen from among the working members of the Council.

7. Corporate members were admitted to Lloyd's for the first time in the mid-1990s, and individual membership has been in the process of being phased out since 2003. The byelaws provide that, because the amount of external underwriting capacity attributable to corporate external members now stands at between 64 and 90 per cent, four of the six external members on the Council must be corporate external members.¹⁰

Terms of Office

8. The current normal term of office of all three categories of Council member is three years;¹¹ the terms of office of Council members cannot be extended during their term of office,¹² and working members of the Council are not eligible for re-election sooner than

4 See 1982 Act, section 3(3)

5 See Council and Committee byelaw 1(1)

6 See Council and Committee byelaw 13(3). The byelaws are found at: http://www.lloyds.com/Lloyds_Market/Tools_and_reference/Lloyds_Acts_and_Byelaws/Lloyds_Byelaws/

7 See Council and Committee byelaw 13(4) and (5)

8 The definitions section of the 1982 Act defines a special resolution as a resolution passed by separate majorities of: (a) all the working members of the Council; and (b) all the other members of the Council, including the existing nominated members.

9 See 1982 Act, section 3(2)

10 See Council and Committee byelaw 1(4)

11 See Council and Committee byelaw 17

12 See section 3(5)(i) of the 1982 Act and Council and Committee byelaw 17(3)

one year after the expiry of their previous term.¹³ There is an exception: if the Council so decides, the Chairman and Deputy Chairmen can be re-elected immediately after the expiry of the term of office, but only once.¹⁴ The current maximum term of office of the Chairman is therefore six years.

3 Preconditions and tests for LROs

9. The relevant tests for a legislative reform order (LRO) made pursuant to section 1 of the LRRRA are set out in that Act. In addition, our standing orders require us to consider whether LROs give rise to issues under the criteria for consideration of statutory instruments in Standing Order No. 151 (such as whether the draft Order purports to have retrospective effect) and whether the draft Order purports to make an inappropriate use of delegated legislation.

10. In the present case, we do not believe that any issues arise under Standing Order No. 151, nor that there are any issues of proportionality or constitutional significance. The term “constitutional significance” in the LRRRA refers to matters of national constitutional rather than corporate constitutional significance. Therefore in this report we address only other criteria.

4 What the draft Order proposes

11. The background to and detailed reasoning for the proposed reforms are set out in paragraphs 2.13 to 2.19 of the ED, and this report does not rehearse the reasoning behind the reforms where to do so would merely reiterate the facts and arguments already set out at length in that document. The eight proposed reforms are:

- i. Relaxing the rules on appointments of the Chairman and Deputy Chairman of the Council
- ii. Relaxing the rules on elections to the Council
- iii. Removing the requirement for the Governor of the Bank of England to approve the Council's nominated members
- iv. Abolishing the Committee
- v. Reforming the rules on delegation by the Council
- vi. Relaxing the rules on disciplinary committees
- vii. Removing the restriction that access to the Lloyd's market must involve a Lloyd's broker

¹³ See section 3(5)(ii)

¹⁴ See section 3(5)(iii), although the subsection further stipulates that this applies only in respect of one of their number at a time

viii. Repealing the provisions that required divestment of interests between brokers and managing agents.

12. The reforms were proposed by Lloyd's itself and are designed to improve governance and competitiveness. Additionally, there is a wish to overcome deficiencies in the current mechanism for safeguarding against conflicts of interest; namely, the divestment provisions in the 1982 Act which forced the divestment of managing agents from brokers and thereafter their continued separation. That mechanism can be circumvented by complex ownership arrangements which are able to mask common ownership.

Consultation and EGM

13. Consultation on the proposals took place between 7 March and 30 May 2008. The consultation can be found at:

www.hm-treasury.gov.uk/consultations_and_legislation/lloydsact/consult_lloyds_act.cfm.

All Lloyd's members were contacted, together with 258 other individuals and organisations including all Lloyd's brokers and managing agents.¹⁵ There were 69 responses. The ED contains a table summarising the consultation responses, which is reproduced here.

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

¹⁵ Managing agents are the administrators of Lloyd's syndicates

14. It is also noteworthy that, at an extraordinary general meeting of Lloyd's members on 21 May 2008, the then draft LRO¹⁶ was approved on the basis of 99.14% of the capacity-weighted membership.¹⁷ The turnout was 51.77%.

15. The ED explains that the proposed market reforms attracted most comment, although the first two proposed governance reforms also caused considerable reaction. Twelve respondents raised objections to the proposals. Six of those objections concerned proposal 7 only. It is noteworthy that only proposal 7 attracted opposition from more than 10% of the respondents, and that the other reforms attracted nearly 90% support or greater. Three respondents objected that the LRO would be an inappropriate use of the powers under the LRA because the LRO would make significant amendments to a local Act that was introduced into Parliament following extensive consultation with Lloyd's members and after full discussion in Parliament.

16. In light of the above, we believe that the proposals have been the subject of adequate consultation. For the reasons stated hereafter, we further believe that the proposals have taken proper account of the consultation. We therefore believe that proceeding by means of an LRO is appropriate in this instance. Amendment of local Acts is expressly contemplated by section 1 of the LRA. Parliament can revisit the position in due course by way of further debate, order or statute, should it be necessary.

The Proposals

Proposal 1: Relax the Section 4 1982 Act requirement for the Chairman and Deputy Chairmen to be elected from the working members on the Council

17. The ED explains that the original justification for this requirement seems to have been the view that “experience of working in the Lloyd's market was essential for effective leadership at Lloyd's.”¹⁸ However, the introduction of corporate capital in 1994 and the phasing out of individual membership since 2003 mean that the pool of working members is shrinking (from 4,209 in 1982 to 956 in 2008, of whom 553 were non-underwriting members.) It is correct that modern corporate governance views external experience as being valuable, and it is clearly important that a body with the profile of Lloyd's should be able to employ leadership of high calibre. **We agree that there should be the capacity to recruit the Chairman and Deputy Chairmen from a broader pool of candidates than is currently permitted without the need for outside candidates to spend time as working members in order to qualify (as has already happened) and concur with the view that the current situation constitutes an administrative burden.**

18. In order to ensure that there remains a broad basis of support for a proposed Chairman or Deputy Chairmen, the draft LRO provides that their election should henceforth take place by special resolution.¹⁹ It further provides that, if the Chairman is not a working

16 The principal difference between the draft LRO that was circulated on consultation and the LRO as laid is that the former envisaged a statutory nine-year cap on the Chairman's term of office; but see paragraph 20

17 That is, capital capacity

18 ED paragraph 4.4

19 See footnote 8

member, at least one Deputy Chairman must be a working member. **We believe that those provisions provide adequate safeguards, and therefore agree that the proposal meets the requirements of the LRRRA relating to fair balance, necessary protections and preservation of rights.**

Proposal 2: Remove the term of office restrictions on elections to the Council

19. As explained in paragraph 8 above, working members on the Council other than the Chairman and Deputy Chairmen cannot currently serve consecutive terms. The 1982 Act is silent on service of consecutive terms by external and nominated members, so the position in relation to them is governed by the byelaws, which state that external members can be re-elected for a further three-year term after an initial such term. Thereafter, there must be a gap of a year. Nominated members can remain on the Council indefinitely, subject to re-election. Records of the working members who have served on the Council show that many have been re-elected onto the Council as soon as their one-year break was completed. **It seems to us that the need to deal with such re-appointments creates an administrative burden without providing an adequate safeguard against excessive tenure of office.**

20. The proposal would remove the current statutory restriction and allow Lloyd's to determine its own rules on terms of office in accordance with good governance practice including as set out in the Combined Code on Corporate Governance.²⁰ Lloyd's has confirmed that it will establish relevant byelaws, including for a maximum period of office of nine years for all Council members other than the CEO.²¹ **In light of that, we agree that the proposal is an improvement on the existing position and meets the requirements of the LRRRA already mentioned in relation to Proposal 1.**

Proposal 3: Remove the requirement for approval of nominated members of the Council from the Governor of the Bank of England

21. This requirement of the 1982 Act predates the supervision of Lloyd's by the Financial Services Authority (FSA). The FSA now has an obligation to approve all Council Members, and the Bank of England supports removal of the requirement. **Given the requirement for the FSA to approve nominated members, and the support of the Bank of England for a revised procedure, it seems to us that the proposal would remove a burden and would meet the criteria of the LRRRA mentioned above in relation to Proposal 1.**

Proposal 4: Remove the provisions establishing the Committee of Lloyd's

22. As explained in paragraphs 4.48 and 4.49 of the ED, the Committee (which under the 1982 Act can consist only of working members) has to all intents and purposes become redundant, with the executive functions of the Council being now exercised largely by way of other bodies—notably the Franchise Board, which unlike the Committee can take advantage of external expertise and on which the representation of working members

20 <http://www.frc.org.uk/CORPORATE/COMBINEDCODE.CFM>

21 See ED paragraph 4.36

could always be boosted if that were felt appropriate. **We agree that a statutory requirement to continue the existence of a body that has been superseded creates a burden. It seems to us that this proposal removes that burden and meets the requirements of the LRRA mentioned in relation to Proposal 1.**

Proposal 5: Reform the delegation rules

23. Section 6(5) of the 1982 Act currently restricts the extent to which the Council can delegate certain of its powers such that delegation other than to the Chairman, the Deputy Chairmen and the Committee is not permitted. The redundant nature of the Committee makes this provision something of an anachronism, and the restrictions on delegation powers make it necessary to rely unduly on the agency powers in section 6(7),²² which has been a cause of litigation owing to the uncertain nature of agency powers. Consequently, there is a desire to extend the scope for delegation along the same broad lines as are permitted in relation to companies by the Department for Business, Enterprise and Regulatory Reform's recommended model company articles—subject always to maintaining the provision in the 1982 Act that requires delegation to be approved by Council special resolution, and maintaining the current position in relation to the Council's reserved powers.²³ **It seems to us that this proposal would reduce burdens by reducing the scope for ambiguities in relation to delegation arrangements and by making the delegation powers less restrictive. Subject to the continued requirement for delegation to be approved by special resolution of the Council, we consider that the proposal meets the relevant requirements of the LRRA.**

Proposal 6: Relax the rules on membership of the Disciplinary Committee

24. Section 7(1) of the 1982 Act currently requires the majority of members of a disciplinary committee to be members of Lloyd's, with the objective of ensuring an appropriate level of knowledge of the market and an element of peer review. However, following the introduction of corporate membership, the current arrangements fail to address the situation of directors of Lloyd's corporate members—who are subject to the disciplinary procedures, but who generally are not themselves members of Lloyd's. It appears that there have also been practical difficulties in finding the requisite number of members to sit on disciplinary committees. The proposal would remove the current restriction and replace it with a requirement that the disciplinary tribunal consist of at least one working member, corporate member director, FSA-approved underwriting agent employee or FSA-approved Lloyd's broker employee, or someone who has retired from one of those occupations.

25. **Whilst we agree that the current requirements appear to operate as a burden, the nature of this proposal makes it important to consider whether a necessary protection or important rights and freedoms would be affected.** In consultation, 41 respondents commented on the proposal, of whom 39 were in favour and two objected. The main

22 Section 6(7) confirms the power of the Council and the Committee to act by persons, committees, sub-committees and other bodies whose members may include persons who are not members of Lloyd's, and through employees, but this is an agency power rather than a delegation power.

23 See section 6(5) and the subsections to which that refers

objection was from a member who preferred the existing arrangements on the basis of the importance of continued judgment by peers. Another respondent questioned whether a narrower list of peer members would be preferable, with greater scope for two working members to sit on the panel.

26. In light of the protection afforded by the proposed replacement provisions, and given the support in consultation, **we conclude that the proposal meets the requirements of the LRRRA, although we recommend that there be a review of the revised rule on membership of a disciplinary committee in due course.**

Proposal 7: Remove the restriction that requires Lloyd's managing agents generally to accept and place business only from or through a Lloyd's broker

27. Under the 1982 Act, Lloyd's brokers are defined as partnerships or bodies corporate permitted by the Council to broke insurance business at Lloyd's. The Act currently permits underwriters to accept or place business only from or through such Lloyd's brokers or such other persons as the Council may by byelaw permit.²⁴

28. In practice, the Council already uses the byelaw exemption to permit business to be channelled through other routes, such as (for commercial life and commercial motor insurance) through brokers regulated by the FSA or which have a guarantee from a Lloyd's broker, so the restriction is not absolute. The ED gives the following principal further reasons for the proposal. First, the restriction is unique to Lloyd's and therefore is not faced by Lloyd's competitor insurance markets, with the result that Lloyd's is placed at a competitive disadvantage. Having a freer and more extensive range of brokers would, it is argued, allow greater scope for pursuing new business. Secondly, the Insurance Mediation Directive ("IMD")²⁵ now subjects all EU insurance brokers to regulation by their home regulator—the FSA in the case of the UK. Although Lloyd's has streamlined its process for registering brokers in light of the IMD, the 1982 Act restriction perpetuates the need for full registration, which imposes an administrative burden.

29. The proposal is that the value added by specialist Lloyd's brokers should be recognised through continuation of the designation "Lloyd's broker", and that Lloyd's should have express power to regulate on standards for intermediation with the Lloyd's market by brokers other than Lloyd's brokers, thereby maintaining standards across the whole range of brokers who deal with Lloyd's. Subject to consultation on appropriate byelaws, all such brokers will be required to show, inter alia, that they are properly regulated under the IMD or equivalent standards outside of the EU and have adequate professional indemnity insurance.

30. In consultation, eight out of 48 respondents objected to the proposal, and a further two expressed reservations. Initial objections from Lloyd's brokers were founded on concerns about potentially lower standards applying to their competitors. Following those

²⁴ See section 8(3) of the 1982 Act

²⁵ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002L0092:EN:HTML>; the directive's objective is to further the creation of a single market in insurance by creating greater standardisation of national rules on insurance mediation

objections, Lloyd's confirmed its intention to require the application of the same standards to all brokers across the board. as a result of which the body representing Lloyd's brokers, the London Market Insurance Brokers Committee, withdrew its objections, although some individual objections remained. These are spelled out in paragraphs 5.37 to 5.46 of the ED. In particular, there were concerns that the estimates of cost savings contained in the initial impact assessment did not withstand scrutiny. As a result, the impact assessment was changed, and no longer attempts to quantify such savings. We pursued this point in our correspondence with the Treasury,²⁶ whose response was based on qualitative arguments derived from general theory of competition as well as, perhaps more importantly, feedback from discussion with brokers.

31. It seems clear that the proposal could affect the interests of current designated Lloyd's brokers by subjecting them to greater competition. However, we do not believe that a monopoly right (particularly one that, in any case, is already limited) is a right or freedom that can reasonably be expected to exist in perpetuity. Our view is that, notwithstanding the lack of agreed quantified benefits, the opening of the market to greater competition is broadly to be welcomed as being in the public interest and in the interest of development of that market, that the proposal strikes a fair balance with those potentially adversely affected and that it would remove a burden. **We agree that it would be inappropriate to use the existing byelaw exemption to neutralise the restriction in the 1982 Act entirely, and we therefore agree that a change in legislation seems necessary to effect the reform. We note that the effects of the LRO will all be reviewed after five years.²⁷ Given those considerations, we agree that the proposal is appropriate.**

Proposal 8: Repeal the "divestment" provisions

32. The divestment provisions were the most extensively debated provisions of the 1982 Act, and evidence and submissions on them took up considerable time at the Committee stage of the 1982 Bill. They required Lloyd's brokers and managing agents to divest their interests in each other with the aim of preventing conflicts of interests. Such conflicts include those arising from situations such as brokers placing business with a managing agent who is preferred over another not on the basis of advantage to the policyholder but because of a connection with the broker. They also include conflicts arising from a managing agent placing business with a capital provider for reasons of association with a broker rather than in the fair interests of that capital provider.

33. The provisions are now believed to be obsolete for two principal reasons. First, they are structure-based rather than effects-based and do not prohibit all associations, which means that they are vulnerable to circumvention and complex to administer. Secondly, since 1982 the FSA has promulgated conflicts of interest principles with full and specific applicability to Lloyd's.

34. The proposal would therefore remove the divestment provisions, but add a requirement of additional disclosure upon managing agents. Managing agents will be

²⁶ See the annex to the report containing the correspondence

²⁷ See the impact assessment annexed to the ED, at paragraph A28

required by a combination of byelaws and amendments to Accounting Regulations²⁸ to set out, in syndicate business plans, the parameters under which they will conduct business with associated brokers, to identify any associations with brokers, and to report regularly both to Lloyd's and to syndicate members the proportion of business with associated brokers.

35. In consultation, 40 respondents were in favour, one expressed reservations, and four were against. We note the objections that were made to the adequacy of FSA control, but we note also the inadequacy of the current regulatory provisions and the proposal for additional disclosure. As noted in paragraph 32, it is correct that the divestment provisions were the subject of extensive debate at the time of the 1982 Act. However, they are clearly no longer an ideal solution. The proposed regime has attracted a large majority of support and would appear to have substantial merit, and the impact assessment notes that the effectiveness of the new disclosure mechanism will be the subject of continuing review by the FSA, as well as being re-examined at the time of the five-year review of the LRO. We suggest that the FSA set a date for an active review of the effectiveness of the new measures after an appropriate period of implementation.

36. We agree that the proposal removes a burden and, given the additional regulatory supervision that will be put in place to require disclosure alongside existing safeguards, we believe that the proposal meets the LRRRA requirements in relation to necessary protections, rights and freedoms, although in the light of concerns about financial regulatory matters we strongly recommend an early review of the effectiveness of the new regime.

Other proposals

37. There were several additional proposals for other reform from consultation respondents and by way of other submissions, including a proposal to remove Lloyd's immunity from liability in damages under section 14 of the 1982 Act. While acknowledging that these additional proposals might merit further consideration, we do not believe that they need hinder progress of this particular draft Order.

5 Conclusions

38. The Government has recommended that the draft Order be proceeded with under the affirmative resolution procedure. **For the reasons set out above, we agree that the affirmative procedure is appropriate in this case. We recommend that the draft Order be approved and proceeded with in accordance with section 17(2) of the Legislative and Regulatory Reform Act 2006.**

28 See ED paragraph 5.54

List of written evidence

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Appendix 1

Letter from Inquiry Manager of the Committee to HM Treasury: request for information

After an initial review of the LRO and accompanying documents, the following is a list of preliminary questions relating to the order. I shall be reviewing the consultation documents in more detail over the course of the next weeks and will almost certainly have more questions after that further review. However, the initial questions are these:

- How does the Treasury justify the abolition of the current restriction that only Lloyd's brokers can act as intermediaries in the placing of business with underwriters, given that the financial part of the cost-benefit analysis with respect to that proposal has now effectively been removed as a result of criticisms made during consultation? There is an assumption that review of the implemented proposal after two or three years will show benefits, but at least one consultee has challenged that assumption. What is the concrete basis for it?
- How does the Treasury respond to the criticism that the proposed means of managing conflicts of interest will not adequately replace the divestment provisions that were a crucial element of the 1982 Act and that the draft order should be modified to attach a specific code for managing conflicts of interest? In particular, how does the Treasury respond to criticisms in consultation that the FSA will not be able properly to monitor conflicts and that the proposed code is inadequate?
- Why have the governance and market reforms been presented as a package that must stand or fall together, when on the face of it the market reforms (which seem to be the more controversial of the two classes of proposal) are self-standing and could form part of a more extensive and fully debated private bill for more wide-ranging reform of Lloyd's?
- Given the potential position of nominated members in casting deciding votes in the Lloyd's Council, how does the Treasury respond to the argument that the FSA should have more than a mere rubber-stamping duty in relation to their appointment if it replaces the Bank of England as the body with responsibility for endorsing such appointments?
- How does the Treasury answer the criticism made by some consultees that the proposed governance changes are merely an expedient to extend the chairmanship of the current Chairman? Will the Treasury confirm the origin of the proposals, whether they have been amended since inception and, if so, in what way and by whom?
- Please provide a comprehensive table indicating the aims and functions of each of the various bodies representing individuals, associations and organisations with an interest in Lloyd's (including, for example, the major informal associations of underwriters and names), to allow evaluation of whether the consulted parties represent a proper cross-section of interested bodies.
- Please provide a detailed comparative explanation setting out the equivalent divestment/conflict of interest provisions and intermediary restrictions that apply to Lloyd's major competitor bodies and jurisdictions and any current proposals for reform thereof.
- What are the powers of the Lloyd's Chairman compared with the Deputy Chairman, and of each compared with the Council? Can the Council overrule the Chairman and Deputy Chairman acting together or separately and, if so, by what mechanism? Does either the Chairman or Deputy Chairman have a casting vote in Council?
- What is the formal mechanism of delegation of power to the Franchise Board and the precise reasons why the current Committee could not be reconstituted as the Franchise Board.

In the interest of receiving full answers to the above questions, and given that it is the vacation period, I suggest Friday 8 August as the appropriate date for provisions of responses to the above questions. I shall assume that that is acceptable unless I hear from you.

22 July 2008

Appendix 2

Letter from HM Treasury to the Inquiry Manager of the Committee: response to request for information (Footnotes are Treasury footnotes)

Issue	Annex
General questions on the package	
1. Why have the governance and market reforms been presented as a package that must stand or fall together, when on the face of it the market reforms (which seem to be the more controversial of the two classes of proposal) are self-standing and could form part of a more extensive and fully debated private bill for more wide-ranging reform of Lloyd's?	
2. How does the Treasury answer the criticism made by some consultees that the proposed governance changes are merely an expedient to extend the chairmanship of the current Chairman? Will the Treasury confirm the origin of the proposals, whether they have been amended since inception and, if so, in what way and by whom?	
3. Please provide a comprehensive table indicating the aims and functions of each of the various bodies representing individuals, associations and organisations with an interest in Lloyd's (including, for example, the major informal associations of underwriters and names), to allow evaluation of whether the consulted parties represent a proper cross-section of interested bodies.	Annex 1
Proposal-specific questions	
4. What are the powers of the Lloyd's Chairman compared with the Deputy Chairman, and of each compared with the Council? Can the Council overrule the Chairman and Deputy Chairman acting together or separately and, if so, by what mechanism? Does either the Chairman or Deputy Chairman have a casting vote in Council?	Annex 2
5. Given the potential position of nominated members in casting deciding votes in the Lloyd's Council, how does the Treasury respond to the argument that the FSA should have more than a mere rubber-stamping duty in relation to their appointment if it replaces the Bank of England as the body with responsibility for endorsing such appointments?	
6. What is the formal mechanism of delegation of power to the Franchise Board and the precise reasons why the current Committee could not be reconstituted as the Franchise Board.	
7. How does the Treasury justify the abolition of the current restriction that only Lloyd's brokers can act as intermediaries in the placing of business with underwriters, given that the financial part of the cost-benefit analysis with respect to that proposal has now effectively been removed as a result of criticisms made during consultation? There is an assumption	

that review of the implemented proposal after two or three years will show benefits, but at least one consultee has challenged that assumption. What is the concrete basis for it?	
8. How does the Treasury respond to the criticism that the proposed means of managing conflicts of interest will not adequately replace the divestment provisions that were a crucial element of the 1982 Act and that the draft Order should be modified to attach a specific code for managing conflicts of interest? In particular, how does the Treasury respond to criticisms in consultation that the FSA will not be able properly to monitor conflicts and that the proposed code is inadequate?	
9. Please provide a detailed comparative explanation setting out the equivalent divestment/ conflict of interest provisions and intermediary restrictions that apply to Lloyd's major competitor bodies and jurisdictions and any current proposals for reform thereof.	Annex 3

Q 1 Why have the governance and market reforms been presented as a package that must stand or fall together, when on the face of it the market reforms (which seem to be the more controversial of the two classes of proposal) are self-standing and could form part of a more extensive and fully debated private bill for more wide-ranging reform of Lloyd's?

Answer

1. The Government believes that both the governance and market-related reforms will benefit Lloyd's in terms of helping Lloyd's maintain its competitiveness. The consultation paper was drafted in such a way as to allow respondents to comment on the proposals separately on their merits, or to comment on some but not all of the proposals.

2. In the event, the consultation feedback confirmed that a significant majority of respondents wanted all the proposals to go forward. None of those responding suggested that the market reform proposals should be split from the governance proposals or subject to a different procedure. (This was consistent with the feedback from the pre-consultation, where none of those whose opinions were sought suggested consultation should be split in this way.)

3. It is also worth noting (see also question 2 below) that there was consultation and debate within Lloyd's about options for reform (both to the market and to governance arrangements) prior to the Treasury's involvement in developing proposals for a Legislative Reform Order. In particular, there was debate in Lloyd's concerning the role of brokers (prior to the introduction of the Insurance Mediation Directive) and again, in relation to the proposals of the Chairman's Strategy Group (CSG). The CSG report, which was sent to all members and was approved by an EGM in 2002²⁹, recommended that as part of its strategy for reform, Lloyd's should seek to remove requirements in the 1982 Act that constituted "unnecessary business interference", and that this should include looking again at the role of brokers and seeking removal of the divestment provisions. This means the ideas for reform in these two areas had already been subject to discussion at Lloyd's among the membership before they were considered by the Government for inclusion in the draft Legislative Reform Order.

Q 2 How does the Treasury answer the criticism made by some consultees that the proposed governance changes are merely an expedient to extend the chairmanship of the current Chairman? Will the Treasury confirm the origin of the proposals, whether they have been amended since inception and, if so, in what way and by whom?

²⁹ See reference in Explanatory Document paragraph 5.13.

Answer

4. The purpose of the draft Order as a whole is to help Lloyd's maintain its competitive position, by modernising the governance arrangements at Lloyd's and removing unnecessary restrictions on how Lloyd's organizes its affairs.

5. There are two proposals that impact on the positions of the Chairman and Deputy Chairmen (out of six governance reforms). The aim of these proposals is to give Lloyd's greater flexibility over recruitment to the roles of Chairman and Deputy Chairmen (proposal 1), and to remove restrictions in the election rules to permit greater alignment with the Combined Code on Corporate Governance (proposal 2). While the second proposal has a bearing on the position of the current Chairman (although its effects are much wider) and Lloyd's has clearly and publicly explained the effect on the current Chairman; the first proposal is of at least equal importance and does not affect the position of the current Chairman, who is a working member of Council. It will be for the Council of Lloyd's to decide, by passing an annual special resolution, on who it wishes to see as Chairman or Deputy Chairman.

6. In terms of the origin and development of the proposals, the Treasury can confirm that the proposals originated with Lloyd's. There have been many consultations at Lloyd's on governance and market matters. However, the immediate history of the proposals is as follows:

- 2002: Following a consultation process begun in January 2002, the Chairman's Strategy Group published a report in July 2002 which was sent to all members and laid out a programme of major changes for Lloyd's.³⁰ As part of this programme, the CSG recommended that Lloyd's should seek a wide range of amendments to Lloyd's Act 1982, including extensive reforms on governance and business arrangements, but also more fundamental aspects of Lloyd's constitution such as voting rights. The route envisaged at this stage was a Private Bill as Lloyd's had not considered whether a Regulatory Reform Order (RRO) could be used to amend local Acts and of course the Legislative and Regulatory Reform Act 2006 was not in force at that time. The CSG proposals were approved at an EGM on 12 September 2002 by a vote of 78.9% (on a capacity weighted basis).
- March 06: Lloyd's approached the Treasury to ask if the Government would promote an RRO to cover a limited set of reforms in relation to governance and market arrangements at Lloyd's, and made some preliminary suggestions as to what such an Order might contain.
- September 06: Following discussions with the Treasury, Lloyd's revised its proposals. It decided it did not wish to pursue three of its preliminary suggestions, two of which would have involved more fundamental changes affecting the membership of Lloyd's (which Lloyd's did not wish to consider further without detailed discussions with stakeholders), and the other of which sought the repeal of Schedule 2 to the 1982 Act (which sets out an illustrative list of the purposes for which byelaws can be made). In addition, these proposals were not felt to be appropriate for inclusion in an RRO.
- January 07: The Association of Lloyd's Members (ALM) wrote to the Treasury to explain that Lloyd's had consulted the Association on its outline proposals and that the ALM was supportive.
- June 07: The Government announced its decision to develop proposals for a Legislative Reform Order.
- Autumn 07: Development stage of proposals: at this stage, the Treasury concluded that one of Lloyd's proposals (that section 9 should be amended to remove the requirement that bankruptcy or insolvency results in automatic cessation of membership of the Society) should not be taken forward, and made amendments to eight of the remaining nine proposals to ensure all the proposals met the pre-conditions of the LRRRA 2006 and catered for potential sensitivities in the market.

³⁰ The CSG was established by the Council to examine the major strategic threats and opportunities facing Lloyd's. Its specific objective was to determine: "The future vision and strategy for Lloyd's which will maximise the wealth of capital providers to Lloyd's over the next 10 years". The CSG's membership was drawn from all the major market constituencies, and it was chaired by Sax Riley, the then Chairman of Lloyd's.

- Pre-consultation: As a result of the pre-consultation, one proposal (to provide greater flexibility for arrangements dealing with arbitration concerning membership classification), was dropped, and further amendments were made to proposals concerning the Chairman (LRO proposal 1) and re-elections to Council (LRO proposal 2). Proposals for increased disclosure on the repeal of the divestment provisions were developed further (LRO proposal 8).
- Consultation: As set out in the Explanatory Document, further amendments were made by the Treasury to the proposal concerning re-elections to Council (LRO proposal 2) in the light of consultation.

Q 3 Please provide a comprehensive table indicating the aims and functions of each of the various bodies representing individuals, associations and organisations with an interest in Lloyd's (including, for example, the major informal associations of underwriters and names), to allow evaluation of whether the consulted parties represent a proper cross-section of interested bodies.

See Annex 1.

Proposal 1

Q 4 What are the powers of the Lloyd's Chairman compared with the Deputy Chairman, and of each compared with the Council? Can the Council overrule the Chairman and Deputy Chairman acting together or separately and, if so, by what mechanism? Does either the Chairman or Deputy Chairman have a casting vote in Council?

7. The powers of the Council, the Chairman and the Deputy Chairmen derive from Lloyd's Act 1982, and from byelaws made under that Act. Section 1 of the Act makes it clear that power to govern the Society lies with the Council. Under section 6(1):

“The Council shall have the management and superintendence of the affairs of the Society and the power to regulate and direct the business of insurance at Lloyd's and it may lawfully exercise all the powers of the Society, but all powers so exercised by the Council shall be exercised by it in accordance with and subject to the provisions of Lloyd's Acts 1871 to 1982 and the byelaws made thereunder.”

8. In addition, section 6(2) of Lloyd's Act 1982 provides:

“The Council may –

- (a) make such byelaws as from time to time seem requisite or expedient for the proper and better execution of Lloyd's Acts 1871 to 1982 and for the furtherance of the objects of the Society, including such byelaws as it thinks fit for any or all of the purposes specified in Schedule 2 to this Act and
- (b) amend or revoke any byelaw made or deemed to have been made hereunder.”

The Chairman and the Deputy Chairmen are not allocated specific powers under the Act, though the Council is given power to delegate powers to them under section 6(3) which are not required to be exercised by special resolution.

9. As set out below, any such delegation may be amended or revoked by the Council under section 6(10) of the Act, by special resolution. No such delegation prevents the Council from continuing to exercise the powers or functions delegated.

10. The Council has powers to make byelaws “for regulating the appointment, powers and functions of the Chairman and Deputy Chairmen of Lloyd's” under paragraph (8) of Schedule 2 to the Act. However, this power has been sparingly exercised. Generally Lloyd's does not seek to name in its byelaws specific office holders to take decisions and instead decisions are taken by or on behalf of the Council.

11. Annex 2 sets out the powers granted to the Chairman and Deputy Chairmen by byelaw. The majority of specific byelaw powers relate, as would be normal in any company, to ensuring the proper conduct of general meetings and meetings of Council. These powers (under the Annual and Extraordinary General Meetings Byelaw) are given to the chairman of the meeting, who may be the Chairman of Lloyd's, or a Deputy Chairman. The other powers referred to in Annex 2 are also given to both the Chairman, and to the Deputy Chairmen.

Can the Council overrule the Chairman and Deputy Chairman acting together or separately and, if so, by what mechanism?

12. Section 6(10) of Lloyd's Act 1982 provides

“A delegation under this section is revocable by special resolution of the Council and shall not prevent the exercise of a power or the performance of a function by the Council itself.”

Where the Chairman or the Deputy Chairman is exercising powers delegated by the Council, the Council is therefore able to overrule them.

Does either the Chairman or Deputy Chairman have a casting vote in Council?

13. No.

Proposal 3

Q 5 Given the potential position of nominated members in casting deciding votes in the Lloyd's Council, how does the Treasury respond to the argument that the FSA should have more than a mere rubber-stamping duty in relation to their appointment if it replaces the Bank of England as the body with responsibility for endorsing such appointments?

14. Nominated members carry out a controlled function in relation to the governance of Lloyd's, and as such must be approved under section 59 of the Financial Services and Markets Act 2000 (FSMA). This requires an application for approval to be made under section 60 of FSMA. That application may, under section 61, only be granted if the Authority is “satisfied that the person in respect of whom the application is made ... is a fit and proper person to perform the function to which the application relates.”

15. The criteria which the FSA consider in making this determination are set out in detail in the FIT section of the FSA handbook, and make it clear that the FSA's role is not limited to “rubber-stamping” applications for approval. The most important considerations (as set out in FIT 1.3.1) are the person's: (1) honesty, integrity and reputation; (2) competence and capability; and (3) financial soundness.

16. As noted in FIT 1.3.2, “In assessing fitness and propriety, the FSA will also take account of the activities of the firm for which the controlled function is or is to be performed, the permission held by that firm and the markets within which it operates.”

17. In contrast, the Bank of England is not subject to a statutory duty to apply any particular criteria in considering whether or not to confirm the appointment of a nominated member. The Bank of England supports the reform proposed in the draft Order.

18. It is worth noting that the Fisher Report (1980), whose recommendations formed the basis of Lloyd's Act 1982, specifically envisaged that the process of confirming the appointment of nominated members might be carried out by “some other authoritative and independent confirming authority”, if the Governor was unwilling to undertake the role. The Treasury believes that such an independent confirming authority now exists, namely the FSA, which did not exist in 1982, and which is now best placed to undertake this role.

Proposal 5

Q 6 What is the formal mechanism of delegation of power to the Franchise Board and the precise reasons why the current Committee could not be reconstituted as the Franchise Board.

19. The Council does not delegate powers to the Franchise Board. Instead, the Franchise Board acts as agent of the Council under section 6(7) of Lloyd's Act 1982—

“Nothing in subsections (5) and (6) above shall operate to limit the power of the Council or of the Committee to act by persons, committees, subcommittees or other bodies of persons, whose members may include persons who are not members of the Society, or by the employees of the Society.”

20. This arrangement is unusual and often requires considerable explanation to those with whom the Society deals. Its operation and effect has, from time to time, given rise to challenges before Lloyd's Appeal Tribunal.

21. The Franchise Board was implemented following extensive consultation with Lloyd's members and the Lloyd's market and following the EGM held in 2002 (referred to in paragraph 6 above).

22. The Franchise Board comprises the Chairman of Lloyd's, Lloyd's Chief Executive Officer, Lloyd's Finance and Risk Management Director, Lloyd's Franchise Performance Director, 3 individuals who are insurance professionals connected to the Lloyd's market and 4 others who are fully independent of the Lloyd's Market.

23. The Committee could not be reconstituted as the Franchise Board because under section 5 Lloyd's Act 1982 the Committee of Lloyd's may only comprise working members.

Proposal 7

Q 7 How does the Treasury justify the abolition of the current restriction that only Lloyd's brokers can act as intermediaries in the placing of business with underwriters, given that the financial part of the cost-benefit analysis with respect to that proposal has now effectively been removed as a result of criticisms made during consultation? There is an assumption that review of the implemented proposal after two or three years will show benefits, but at least one consultee has challenged that assumption. What is the concrete basis for it?

24. The central argument for removing the current restriction at section 8(3) of Lloyd's Act 1982 was, and remains, that this rule is an obstacle to efficiency that impedes the future development of the market. This reasoning was set out in paragraph 1.35 of the consultation paper, where the Government stated that the current rule:

“...represents a potential barrier to further business development. Removal of section 8(3) and the limits on access would provide a more open competitive environment and potentially encourage the acquisition of new business at Lloyd's. This would allow further improvements in efficiency and productivity, and benefits Lloyd's and its members, as well as policyholders.”

25. The same reasoning was noted in the Explanatory Document, see paragraph 5.5: “This creates an obstacle to efficiency and hinders free development of the market” and paragraph 5.16 “This is an obstacle to efficiency and productivity as it constrains the development of Lloyd's distribution arrangements ...”. At the very least, preserving the current section 8(3) will preserve a legacy of complexity and uncertainty which Lloyd's competitors do not face whereas by removing this provision Lloyd's will be better placed to determine and adapt its distribution arrangements according to market dynamics.

26. There is a wealth of economic theory to support the proposition that increased competition encourages economic efficiency, and leads to greater productivity³¹. However, *quantifying* benefits arising from future increased competition is not always easy: and in this case was difficult because of conflicting data from the industry.

27. For the LRO consultation, however, the Treasury decided that as well as the potential benefits (such as increased business) which could be expected from the reform but which were not quantified, the partial impact assessment should offer a monetised estimate of potential cost savings, based on figures provided by Lloyd's, as a point for discussion. The savings were expressed as a range (from zero) and it was noted these estimates were very sensitive to assumptions.

28. However, further discussion with the brokers confirmed that there were conflicting assumptions regarding the assessment of potential efficiency savings against existing brokerage patterns in relation to the US part of the Lloyd's market on which the consultation estimates had been based. Working through the estimates with the brokers (as is required under the LRO process³²) therefore led to the conclusion that there was no settled evidence which could be agreed for a monetary estimate for cost savings.

29. However further feedback also confirmed some *qualitative* assessments: in particular, that the reform would allow for greater play of market forces and that this would lead to greater efficiency and potential new business for Lloyd's.

30. The conclusion the Treasury drew from this was that the principled basis for this proposed reform (in terms of removing an obstacle to efficiency) was accepted and therefore stood.

31. In terms of timing for assessing benefits, on the basis of feedback received, the Treasury also concluded that it would be appropriate to adopt a more conservative assumption regarding the timeframe in which benefits could be expected to materialize.

32. The final impact assessment therefore suggests a review point of 5 years (see A.28) rather than the 2-3 years suggested in the partial impact assessment. This length of time would also be consistent with the lead time past experience suggests is necessary to measure the results of opening new platforms /facilities.

33. Finally it is worth reiterating that it would be Lloyd's intention that managing agents be required to apply the same prudential standards required of Lloyd's brokers to all non-Lloyd's brokers placing business into the market. These standards (for Lloyd's brokers) were last revised in 2007, following full market consultation and were introduced with the support of both managing agents and the London Market Insurance Brokers Committee ("LMBC").

Proposal 8

Q 8 How does the Treasury respond to the criticism that the proposed means of managing conflicts of interest will not adequately replace the divestment provisions that were a crucial element of the 1982 Act and that the draft Order should be modified to attach a specific code for managing conflicts of interest? In particular, how does the Treasury respond to criticisms in consultation that the FSA will not be able properly to monitor conflicts and that the proposed code is inadequate?

34. The proposals for repealing the divestment provisions in favour of the introduction of a new transparency mechanism were developed in close consultation with the FSA (as in fact were all the proposals). They reflect the Treasury and FSA view that:

31 A series of papers by BERR and HM Treasury identify competition as one of the five economic drivers of productivity growth. See for example (i) HM Treasury, "Productivity in the UK 6: Progress and new evidence", and (ii) HM Treasury and DTI, "The 2005 productivity and competitiveness indicators". The OECD has also undertaken several studies on product market competition and economic performance: www.oecd.org/eco/structural/competition.

32 The LRO process requires officials to ensure there is as much consensus as possible on the financial implications of any reforms before reforms are presented to Parliament.

- the FSA's principles-based requirements regarding management of conflicts of interest are suitable and apt to cover all issues concerning management of conflicts of interest within the Lloyd's market (absent the divestment provisions);
- adequate protection would certainly be achieved if these rules were supplemented by an appropriate disclosure regime, that provided both pre- and post- transaction transparency in relation to transactions with associated brokers (for more detail on the current proposals, see paragraphs 5.54 to 5.55 of the Explanatory Document, and the proposed amendments to Lloyd's byelaws set out at Annex 2 to the Society of Lloyd's response to the Consultation Document³³); and that
- the principle of FSA oversight would be in keeping with the way the regulatory regime works for all other financial services firms and markets, where the regulatory framework requires risks to be managed rather than eliminated.

Respondents generally endorsed this view, with some noting that the proposal could potentially allow conflicts to be managed better than they are now.

35. The Treasury has chosen not to pursue the proposal suggested in consultation by one of Lloyd's members' agents for an additional Code, enforced through the LRO for two principal reasons.

36. First, it is not clear how the proposed Code of Practice would provide greater protection for names in relation to conflicts of interest which may arise as a result of the repeal of the divestment provisions than the disclosure regime which is already proposed. What the Treasury proposal does is:

- establish the principle that the divestment rules should only be repealed on the basis of the introduction of an appropriate disclosure mechanism, and
- establish a baseline for what that mechanism must involve (as implemented in byelaw and through syndicate accounts and annual report, provided under Insurance Accounting Directives (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008). This will include post transaction disclosure in the syndicate annual report made to members and pre-transaction information relevant to monitoring conflicts of interest will have to be given in the syndicate business plan and will be available to the members of the syndicate, the Franchise Board, and the FSA.

37. As the Explanatory Document notes, there is nothing to prevent the FSA and Lloyd's adding to the protection this mechanism provides, when Lloyd's consults on the byelaw, if detailed regulatory review suggests this is necessary.

38. Second, the particular Code proposed by the members' agent appears to range quite widely over the field of conflicts of interest. For instance, one of the examples of conflicts cited by the members' agent in its submission (p10) concerns conflicts *between capital providers*³⁴ rather than the conflicts of interest that could arise as a result of associations between brokers and managing agents which is the subject addressed by the divestment rules. However, the Treasury is concerned that the proposed transparency mechanism should be relevant to the rules under review and accepted in all quarters of the market (by members, managing agents and brokers). It is less clear that a wider Code such as that proposed would maintain focus on these specific concerns or receive such widespread support. Further, a wider Code would introduce additional burdens on managing agents not directly related to the repeal of the divestment provisions. It is not clear that such a Code could be introduced under the powers given in the Legislative and Regulatory Reform Act 2006.

33 Response number 52.

34 This is the potential conflict that exists between individual third party capital providers and corporate capital providers over capacity transfers, which are governed by Lloyd's Major Syndicate Transactions byelaw. As noted in the Explanatory Document, Chapter 6, the Treasury received several submissions requesting amendment of this byelaw by the LRO.

Q 9 Please provide a detailed comparative explanation setting out the equivalent divestment/conflict of interest provisions and intermediary restrictions that apply to Lloyd's major competitor bodies and jurisdictions and any current proposals for reform thereof.

39. The provisions applying to Lloyd's under sections 10 to 12 of Lloyd's Act 1982 are unique. The Treasury is not aware of any provisions under the law of the United Kingdom, or under EU law which impose equivalent requirements for divestment on the insurance companies which are Lloyd's main competitors.

40. However, all insurance companies, and insurance intermediaries, in the UK are subject to rules made by the FSA under the Financial Services and Markets Act 2000, governing, inter alia, the management of conflicts of interest. Insurance companies in the European Union are also subject to laws made by EU states implementing the provisions of Directive 2002/92 on insurance mediation which sets out the minimum requirements which must be imposed on insurance and reinsurance intermediaries. Insurance intermediaries are also subject to fiduciary duties under the law of agency to those for whom they act to avoid conflicts of interest.

41. The relevant provisions of the FSA handbook and of Directive 2002/92 are set out in Annex 3.

42. The Treasury has not undertaken an analysis of provisions governing the management of conflicts of interest and intermediary restrictions applying in other jurisdictions. It is difficult to obtain full and accurate information on the applicable laws in other jurisdictions, and information on the relevant laws in the UK appears to be of most assistance in determining whether the divestment provisions or the alternative arrangements proposed by the Government are most appropriate in today's environment to deal with the relevant conflicts of interest.

43. Under the Treasury's proposals, the FSA will be responsible for oversight of how Lloyd's manages conflicts of interest. In coming to its views, the FSA will need to consult and take account of feedback. The FSA is required, in carrying out its functions to meet its statutory objectives and to have regard to a number of principles, including the impact on competition and the competitive position of the UK financial services sector

14 August 2008

Annex 1

Organisations with an interest in Lloyd's

Annex B to the Explanatory Document gives a full list of those who were consulted about the proposed LRO, and Annex C gives details of those consultees who responded to the consultation.

As Lloyd's noted in its formal response, the Chairman of Lloyd's wrote individually to every member of the Society on the day that the consultation was launched, drawing their attention to the fact of the consultation and giving details of how they might make their views known to HM Treasury.

In drawing up the list at Annex B, the Treasury's aim was to ensure that anyone with any kind of interest in Lloyd's should be aware of the consultation as soon as possible after 7 March 2008 and should be in no doubt as to how, when, and to whom, they should make their views known. The Treasury wrote to all the main representative organisations in the Lloyd's market and, separately, to all individual brokers, underwriters, members agents, corporate members and advisers to inform them of the consultation. It also wrote to a number of individuals who had previously asked to be kept informed about the changes.

Table 1 below sets out the aims and functions of the various bodies representing individuals, associations and organisations with a specific interest in Lloyd's, who responded to the consultation, or to whom the Treasury wrote to inform them of the consultation..

Table 1. Name	Aims and Functions
Association of Lloyd's Members www.alm.ltd.uk	<p>The Association of Lloyd's Members is the main representative body for Lloyd's Names (i.e. those who provide third party private capital), whether these are sole traders with unlimited liability, or individuals/groups who have set up limited liability vehicles.</p> <p>Names currently provide £2.4 billion of capacity to underwrite in the Lloyd's market. The ALM represents around 1,200 actively underwriting members, between them representing 92% of the £2.4bn capacity provided by Names.</p> <p>The ALM's stated aims are:</p> <ul style="list-style-type: none"> ▪ To fight for the rights of Names. ▪ To maximise the income of members from their underwriting and to increase the value of their capacity. ▪ To work for the creation of a more dynamic and profitable Lloyd's. ▪ To preserve the position of members as substantial providers of capital to Lloyd's. ▪ To ensure a level playing field for all participants in the market. <p>To defend the interests of members no longer underwriting.</p>
High Premium Group	<p>The High Premium Group was set up in 1994 to represent the interests of Lloyd's Names who underwrite large amounts and who want to continue as sole traders with unlimited liability. The criterion for membership is underwriting of at least £1million. Many members of the HPG are also members of the ALM. The HPG currently has about 300 members, including NameCo's and LLP's as well as unlimited liability individual members.</p> <p>The HPG has no official status within Lloyd's, but is regularly consulted</p>

Table 1. Name	Aims and Functions
	<p>about any proposed changes in the Lloyd's market that are likely to affect members. The HPG does not regard itself as providing advice to members, but rather as a source of information and as a forum where members could meet to discuss syndicate performance and market developments.</p>
Cotesworth Action Group	<p>The Cotesworth Action Group is a Names action group comprising certain Names who participated on Lloyd's syndicate 535 for the 1999 – 2001 years of account and Lloyd's syndicate 536 for the 1999 year of account. The underwriting agent of these syndicates was Cotesworth & Co which is now in insolvent liquidation.</p> <p>An application by the action group for compensation under the Lloyd's Member's Compensation Scheme is currently stayed following a preliminary decision of the Member's Compensation Panel in December 2006, pending the action group obtaining the necessary judgment establishing fraud and dishonesty, as required by the Panel.</p>
Names Action for Compensation and Defence in Europe	<p>A Names action group which challenged the UK Government for failing to take the necessary steps to regulate Lloyd's in accordance with EU law and for not properly implementing EU directives. In particular NACDE has brought a claim for damages against the UK Government for losses caused by its alleged failure to implement the EU Insurance Directive between 1976 and 2001. The claims included:</p> <ul style="list-style-type: none"> • alleged failure to implement requirements relating to conditions by which insurance could be underwritten at Lloyd's/monitoring of those requirements; • alleged failure to ensure that there was in place at Lloyd's an adequate system of accounting to ensure that assets/reserves were sufficient to meet liabilities. <p>NADCE's claims against the Government were dismissed by Mr Justice Langley on 8 November 2006. An appeal against that judgment was unsuccessful. The House of Lords refused permission to appeal.</p> <p>NACDE is chaired by Christopher Stockwell, a well known and active critic of Lloyd's who has been a prominent figure in proceedings brought by Names against Lloyd's (particularly through his involvement with the UNO). Mr Stockwell is also Chairman of the LNA. NACDE (and its sister organisation, LNA) also undertake various lobbying activities. These have included an attempt to seek the EU Parliament and the EU Commission to investigate failures by UK Government to properly regulate Lloyd's from 1973 to date. The Commission decided it did not have grounds to bring formal action.</p>
Lloyd's Names Association ("LNA") (previously the Lloyd's Names Associations Working Party (LNAWP))	<p>A Names action group which has, since the early 1990's sought to obtain compensation for alleged deficiencies in the regulation of the Lloyd's market.</p> <p>The Chairman of the LNA is Christopher Stockwell (see section on NACDE above).</p>

Table 1. Name	Aims and Functions
<p>Lloyd's Market Association</p> <p>www.lmalloyds.com</p>	<p>The Lloyd's Market Association is the main representative body for Lloyd's Underwriters. All Lloyd's managing agents are members of the LMA.</p> <p>The LMA's overall objective is to identify and resolve issues which are of particular interest to the underwriting community and, working in partnership with the Corporation of Lloyd's and other partner associations, to influence the course of future market initiatives.</p> <p>The LMA's specific aims are:</p> <ul style="list-style-type: none"> ▪ To provide information on the major issues and initiatives which impact on the underwriting community as a whole. ▪ To provide information on the work being undertaken on Lloyd's and London market claims initiatives and issues by the LMA Executive, Business Panels and Committees. ▪ To support the development of efficient and cost-effective business processes in the Lloyd's market ▪ To monitor and assess the potential impact of developments relating to accounting, reporting, taxation and other financial and regulatory matters which may affect managing agents and syndicates. ▪ To strengthen the work of LMA Members in continuing to "raise the bar" of professional standards, with particular emphasis on training and education. ▪ To lobby and respond to public and regulatory consultations, to assist with the drafting of market wordings and commissioning legal advice to assist our members to understand and interpret regulations, laws and bills.
<p>London Market Insurance Brokers' Committee</p> <p>www.lmbc.co.uk</p>	<p>The London Market Insurance Brokers' Committee is the main trade body, representing the interests of accredited Lloyd's brokers operating in the London and worldwide insurance and reinsurance markets. Its members are responsible for handling in excess of £25bn of premiums through the London Market and many billions more across the World. They generate some £2bn of invisible earnings to the UK economy each year. 148 of the current (as at 23 July 2008) 166 Lloyd's brokers (i.e. 89%) are members of the LMBC.</p> <p>Lloyd's Insurance Brokers Association was formed in 1910. Following the promotion of the Insurance Brokers Registration Act in 1977, LIBA agreed to join with the other insurance broker trade bodies to form the British Insurance Brokers' Association. However, the LIBA, now renamed the LMBC (London Market Insurance Brokers' Committee) was formed specifically to look after the interests of Lloyd's brokers, and remains an autonomous body in so far as matters affecting Lloyd's brokers are concerned.</p> <p>LMBC is committed to developing initiatives and supporting all moves which raise standards and enhance value and quality of service, thus improving broker competitiveness in bringing business not only to London but also to other world insurance and reinsurance markets, where the interest of clients are most effectively served. LMBC is the</p>

Table 1. Name	Aims and Functions
	brokers' champion of LMP reforms and benchmarking.
British Insurance Brokers Association www.biba.org.uk	<p>BIBA is the UK's leading general insurance organisation. It represents the interests of insurance brokers, intermediaries and customers, and has partner members from the leading companies in the insurance industry.</p> <p>BIBA's relationship to the LMBC is described above. BIBA is the nationwide voice of the insurance broking industry - advising members, regulators, consumer bodies and other stakeholders on key insurance issues. In addition, BIBA provides training, schemes and facilities, technical advice, guidance on regulation and business support, and helps to raise – and maintain – industry standards.</p>
Institute of Insurance Brokers www.iib-uk.com	<p>The Institute (IIB) was formed in 1987 as a professional association for over 1,000 insurance broking firms throughout the UK and represents their interests to HM Government, the Financial Services Authority, the EEA Commission and Parliament and all other relevant bodies throughout the World.</p>

Table 2 shows other associations and groups of which we are aware which were not separately informed of the consultation by the Treasury (as noted above, all members of Lloyd's received individual notification of the consultation from the Chairman of Lloyd's giving full details as to how they might obtain a copy of the consultation paper).

Table 2. Name	Aims and Functions
United Names Organisation	A Names action group comprising 50 Names who commenced underwriting at Lloyd's between 1973 and 1990, and who did not accept the Reconstruction and Renewal settlement of 1996. Over 98% of Names agreed to Reconstruction and Renewal in 1996 but a small number of Names have continued to bring claims which have been rejected by the courts –most recently in the High Court decision of Mr Justice David Steele in <i>Heather Mary Adams -v- The Society of Lloyd's</i> [2008] EWHC 1433(Comm))
Europe Names Association www.lloydsnamesineurope.com	A Names action group which has submitted a number of complaints to the European Commission and Petitions to the European Parliament alleging that the UK Government has failed correctly to transpose Directive 73/239 EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, and that had they done so fewer Lloyd's names would have been ruined. It appears that it is no longer active.
The 1173 Action Group	A Names action group formed in mid-2006 comprising certain Names who participated on Lloyd's syndicate 1173 for any of the underwriting years of account 1998, 1999, 2000, and 2001 to investigate the affairs of the syndicate and obtain compensation for losses arising out of the alleged negligence of the syndicate's former managing agent, Cottrell & Maguire Limited
American Names Association http://www.truthaboutlloyds.com	The American Names Association was originally formed to protect the interests of its members, American Names. It now describes its function as: “In addition to its original mandate, the ANA now serves as a source of unique analysis and information for US companies, insurers, legislators, regulators and reporters wanting to better understand the history of the Lloyd's insurance market and how it operates today.” It appears that this group is also no longer active.
The European Federation of Insurance Intermediaries (“BIPAR”) www.bipar.org	BIPAR represents the public affairs interests of insurance intermediaries with European institutions. Its members are 47 national associations of insurance agents and brokers in 32 countries. The 2 UK member associations are the British Insurance Brokers Association (BIBA) and the Association of Independent Financial Advisors. As noted, BIBA was informed of the consultation.

Table 2. Name	Aims and Functions
Association of British Insurers	<p>The ABI (Association of British Insurers) represents the collective interests of the UK's insurance industry. The Association speaks out on issues of common interest; helps to inform and participate in debates on public policy issues; and also acts as an advocate for high standards of customer service in the insurance industry.</p> <p>The Association has around 400 companies in membership. Between them, they provide 94% of domestic insurance services sold in the UK. ABI member companies account for almost 20 per cent of investments in the London stock market.</p>

Annex 2

PROVISIONS IN LLOYD'S BYELAWS RELATING TO THE POWERS OF THE CHAIRMAN

The Annual and Extraordinary General Meetings Byelaw

10. Quorum

(1) The quorum of members of the Society necessary for the holding of a general meeting shall be:

- (a) 100 members present in person or by proxy; or
- (b) the number of members present in person or by proxy to which in the aggregate there is attributable at least one per cent of the total Capacity attributable to all members entitled to attend and vote at the meeting.

(2) If such a quorum is not present within half an hour from the time appointed for the meeting, or if during a meeting such a quorum ceases to be present, the meeting, if convened on the requisition of members, shall be dissolved, and in any other case shall stand adjourned to such time and place as the chairman of the meeting may determine. If at the adjourned meeting a quorum is not present within fifteen minutes after the time appointed for holding the meeting, the meeting shall be dissolved.

11. Chairman

(1) The chair at a general meeting shall be taken by the Chairman of Lloyd's or a Deputy Chairman of Lloyd's or, in his absence, by a person being a member of the Council appointed by the Council to take the chair at such general meeting.

(2) The provisions of this byelaw relating to any powers of the chairman shall apply without prejudice to any powers of the chairman implied by general law.

12. Proceedings at General Meetings

(1) The Council may decide to enable members entitled to attend a general meeting to do so by simultaneous attendance and participation at a satellite meeting place anywhere in the world. The members present in person or by proxy at satellite meeting places shall be counted in the quorum for, and be entitled to vote at, the general meeting in question. That meeting shall be duly constituted and its proceedings shall be valid provided that the chairman of the general meeting is satisfied that adequate facilities are available throughout the general meeting to ensure that members attending at all the meeting places are able to:

- (a) participate in the business for which the meeting has been convened;
- (b) hear and see all persons who speak (whether by the use of microphones, loudspeakers, audio-visual communications equipment or otherwise) in the principal meeting place and any satellite meeting place; and
- (c) be heard and seen by all other persons so present in the same way.

The chairman of the general meeting shall be present at, and the meeting shall be deemed to take place at, the principal meeting place.

(2) If it appears to the chairman of the general meeting that the facilities at the principal meeting place or any satellite meeting place have become inadequate for the purposes referred to in sub-paragraph (1) above, then the chairman may, without the consent of the meeting, interrupt or adjourn the general meeting. All business conducted at the general meeting up to the time of such adjournment shall be valid.

(6) The chairman of any general meeting may make any reasonable arrangement and impose any requirement or restriction he reasonably considers appropriate to ensure the security and orderly conduct of a general meeting including, without limitation, requirements for those attending the meeting to produce evidence of their identity, searches of personal property and restrictions on items that may be taken into the meeting place, and shall be entitled to refuse entry to a person who refuses to comply with such arrangements, requirements or restrictions.

(7) The chairman of the meeting may at any time with the consent of any general meeting at which a quorum is present (and shall if so directed by the meeting) adjourn the meeting to another time or place (or indefinitely). In addition (and without prejudice to the chairman's power to adjourn a meeting conferred by sub-paragraph (2) above), the chairman may at any time, without the consent of the meeting, adjourn the meeting to another time or place or (subject as specified below) indefinitely if it appears to the chairman that:

(a) the number of persons present or wishing to attend cannot be conveniently accommodated in the place or places appointed for the meeting;

(b) the unruly behaviour of any persons attending the meeting prevents or is likely to prevent the orderly conduct of the business of the meeting; or

(c) an adjournment is otherwise necessary so that the business of the meeting may be properly conducted; or

(d) as a result of a material change in circumstances since the despatch of the notice convening the meeting it is expedient in the interests of the Society that the business for which the meeting has been convened should not be proceeded with at the time for which the meeting has been convened. A meeting adjourned under this sub-paragraph (d) shall be adjourned until such time as members of the Society have been adequately informed about the relevant material change in circumstances.

No business may be conducted at any adjourned meeting other than business left unfinished at the meeting from which the adjournment took place.

(8) Any such adjournment may be for such time and/or to such other place (or, in the case of a meeting held at a principal meeting place and a satellite meeting place, such other places) as the chairman of the meeting may, in his absolute discretion determine, notwithstanding that by reason of such adjournment some members may be unable to be present at the adjourned meeting. Any such member may nevertheless execute a form of proxy for the adjourned meeting, which, if delivered by him to the chairman or the Secretary, shall be valid even though it is given at less notice than would otherwise be required by this byelaw. When a meeting is adjourned for 30 days or more or for an indefinite period, at least seven days' notice shall be given specifying the time and place (or places, in the case of a meeting to which sub-paragraph 12(1) or 12(3) applies) of the adjourned meeting and the general nature of the business to be transacted. Otherwise it shall not be necessary to give any notice of an adjournment or of the business to be transacted at an adjourned meeting.

(9) No amendment to a resolution may be considered or voted upon (other than a mere clerical amendment to correct a patent error) unless either:

(a) notice of the text of the amendment and the intention to move it has been served upon the Council at least 48 hours before the date of the meeting or adjourned meeting at which the resolution is to be proposed and the amendment relates to the subject matter of the resolution proposed to be amended; or

(b) the chairman of the meeting, in his absolute discretion, decides that the amendment may be considered and voted on.

If an amendment shall be proposed to any resolution under consideration but shall in good faith be ruled out of order by the chairman of the meeting, the proceedings on the substantive resolution shall not be invalidated

by any error in such ruling. With the consent of the chairman of the meeting, an amendment may be withdrawn by its proposer before it is voted upon.

(10) The chairman of the meeting may permit questions from the floor. The chairman shall ensure that discussion of any proposed resolution is kept within reasonable bounds and may prohibit further consideration of a particular matter once, in his reasonable opinion, such matter has been sufficiently debated and a fair cross-section of views has been heard.

(11) Any motion or point of order shall (unless the chairman of the meeting, in his absolute discretion, otherwise permits) be submitted in writing to the chairman of the meeting in accordance with the procedures determined by him.

13. Attendance and Voting

(1) No one but a member of the Society or of the Council shall be present, speak or take part in proceedings at an Annual or Extraordinary General Meeting without permission of the Chairman of Lloyd's or a Deputy Chairman of Lloyd's or the chairman of the meeting.

14. Voting and Ballot

(1) A resolution proposed at a general meeting convened under section 6(4) of Lloyd's Act 1982 shall be decided upon by a ballot of those members of the Society who are qualified to attend and vote at the meeting and such members may cast their votes in person or by proxy.

(2) A resolution brought forward at a general meeting other than a meeting referred to in sub-paragraph (1) above shall be decided on a show of hands unless before, or at the declaration of the result of, the show of hands a ballot of the members is called for by:

(a) the chairman of the meeting;

(b) not less than 50 individual members; or

(c) a corporate member to which, or corporate members to which in the aggregate, there is attributable not less than two per cent. of the total Capacity attributable to all the corporate members which are entitled to attend and vote at the meeting.

A demand by a person as proxy for a member shall be the same as a demand by the member. Any such ballot shall be taken at the end of the meeting or at such other time as the chairman of the meeting may direct and shall be taken in such manner as the chairman shall direct.

(3) Any demand for a ballot may, with the consent of the chairman, be withdrawn before the ballot is taken. A demand so withdrawn shall not be taken to have invalidated the result of a show of hands declared before the demand was made. If the demand for a ballot is withdrawn, the chairman or any other member or members entitled may demand a ballot.

(6) A ballot may be called for the chairman of the meeting whenever, in his absolute discretion, he thinks it appropriate, including (without limitation) if:

(a) he has reason to believe that the result on a ballot would be different from that on a show of hands;

(b) he considers that the result on a show of hands is unrepresentative; or

(c) he considers the matter to be of such significance that it is appropriate to put it to a vote of the full membership of the Society.

(10) If any votes are counted which ought not to have been counted, or might have been rejected, the error shall not vitiate the result of the voting unless it is pointed out at the same meeting, or at any adjournment thereof and, in the opinion of the chairman of the meeting, it is of sufficient magnitude to vitiate the result of the voting.

(11) No objection shall be raised to the qualification of any voter except at the meeting or adjourned meeting or ballot at which the vote objected to is tendered. Every vote not disallowed at such meeting shall be valid and every vote not counted which ought to have been counted shall be disregarded. Any objection made in due time shall be referred to the chairman whose decision shall be final and conclusive.

16. Scrutineers

(1) At any ballot:

(a) held pursuant to sub-paragraph 14(1) above; or

(b) otherwise ordered by the Council not being a ballot to elect members of the Council,

the Council shall appoint persons as scrutineers to take the vote and report the result.

(2) At any ballot held at a general meeting pursuant to sub-paragraph 14(2) above the chairman of the meeting shall appoint one or more persons present as scrutineers to take the vote and report the result.

Council and Committee Byelaw

17B Power to Grant Indemnity

(1) The Society may from time to time enter into a deed of indemnity with any member of the Council for the time being in such form as the Chairman or a Deputy Chairman of the Council, acting on legal advice, may consider appropriate in the circumstances of that member.

25. Meetings of the Council and the Committee

(1) The Council and the Committee shall meet at such intervals and at such times as they may respectively determine from time to time.

(2) On the instructions of the Chairman or a Deputy Chairman of Lloyd's or of five other members, the Secretary to the Council shall convene a special meeting of the Council by giving not less than 24 hours' notice of such meeting, Provided that:

(a) where at least 24 hours before the time for which such meeting of the Council is convened, the person instructed to convene such meeting shall have sought to give notice thereof to any member by telephone at such member's office (where he has one) and home (as notified to the Secretary to the Council) but is unable to contact him, that member shall be deemed to have received notice of such meeting;

(b) a member of the Council may waive notice of any special meeting and any such waiver may be retroactive; and

(c) a special meeting of the Council shall be deemed to have been properly convened notwithstanding the accidental omission by the person instructed to convene such meeting to notify any member of such meeting unless those members attending such meeting otherwise determine.

Enforcement Requirements³⁵

Application to the Council

4.2 An application to the Council under the Enforcement Byelaw to consider a sanction imposed on a person (“applicant”) in enforcement proceedings shall be made to the Secretary of the Council by the latest of —

- (a) the expiry of the time permitted for serving a Notice of Appeal on the Appeal tribunal; or
- (b) 14 days of the decision of the Appeal Tribunal on an appeal.

4.4 The Chairman or a Deputy Chairman of Lloyd’s shall convene a special meeting of the Council to consider the sanction and shall give the applicant at least 14 days written notice of the special meeting.

Annex 3

UK AND EU LAW RELEVANT TO THE MANAGEMENT OF CONFLICTS OF INTEREST

Conflict of interest provisions under UK law

1.1 Rules on the management of conflicts of interest applicable to insurance companies in the UK (and to all other businesses which are providing financial services regulated under the Financial Services and Markets Act 2000 (“FSMA”)) are laid down by the FSA under its powers under that Act.

1.2 The principles, rules and guidance laid down by the FSA under Part X of FSMA, are set out in full in the FSA Handbook. All businesses engaged in activities which are regulated under FSMA, including managing agents and Lloyd’s brokers, are subject to them. Regulated activities which are particularly relevant to insurance companies and insurance intermediaries are effecting and carrying out a contract of insurance as principal; making arrangements for another person to enter into insurance contracts, advising on such contracts or assisting in the administration and performance of a contract of insurance.

General principles

1.3 The principles set out in the PRIN section of the FSA Handbook state the fundamental obligations of firms under the regulatory system. They apply in whole or in part to every firm regulated under FSMA. The principles most relevant to questions arising in relation to the management of conflicts of interest are:

- (a) Principle 1 – a firm must conduct its business with integrity;
- (b) Principle 6 – a firm must pay due regard to the interests of its customers and treat them fairly;
- (c) Principle 8 - A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.

1.4 Principles 6 and 8 apply only in relation to customers (that is, clients which are not eligible counterparties).³⁶

35 The Enforcement Requirements are contained in Chapter 4 of the Underwriting Requirements, which sets out all the matters prescribed, issued or made by the Council or Franchise Board under the Underwriting Byelaw, the Intermediaries Byelaw, the Overseas Underwriting Byelaw, the Membership Byelaw and the Enforcement Byelaw.

36 An “eligible counter party”, for the purpose of the principles, includes governmental bodies (such as governments, central banks and state investment bodies); another firm or recognised investment exchange, designated investment

1.5 Approved persons (those who exercise controlled functions within the meaning of section 59 of FISMA, and therefore require approval from the FSA)³⁷ are also subject to the principles in the APER section of the FSA Handbook. Principle 1 in APER 4 provides that:

"An approved person must act with integrity in carrying out his controlled function."

Principle 2 in APER 4 provides that

"An approved person must act with due skill, care and diligence in carrying out his controlled function."

1.6 The guidance published in the FSA Handbook on the application on these principles notes that deliberately failing to disclose the existence of a conflict of interest in connection with dealings with a client amounts to failure to comply with Principle 1 (APER 4.1.13). Failing without good reason to disclose the existence of such a conflict amounts to failure to comply with Principle 2 (APER 4.2.10).

1.7 What is considered to breach one of the principles will depend on the facts of a particular case. The FSA guidance notes that "in determining whether a principle has been breached it is necessary to look to the standard of conduct required by the principle in question".

1.8 Further guidance is provided on the application of Principle 8 on the management of conflicts of guidance in ICOBS (the section of the FSA Handbook which sets out rules for the conduct of business by firms carrying out insurance related activities)³⁸. In ICOBS 8.3.3 it is noted that, generally:

(2) [Principle 8] means that a firm handling a claim should not put itself in a position where its own interest, or its duty to anyone for whom it acts, conflicts with its duty to a customer. If it does so, it should have the customer's prior informed consent.

(3) If a firm acts for a customer in arranging a policy, it is likely to be the customer's agent (and that of any other policyholders). If the firm intends to be the insurance undertaking's agent in relation to claims, it needs to consider the risk of becoming unable to act without breaching its duty to either the insurance undertaking or the customer making the claim. It should also inform the customer of its intention.

(4) A firm should consider whether it is possible to manage such a conflict through disclosure and consent. An example where these are unlikely to be sufficient is where the firm knows both that its customer will accept a low settlement to obtain a quick payment, and that the insurance undertaking is willing to settle for a higher amount.

Obligation to inform customers

1.9 Under ICOBS 4.1.1, an insurance intermediary is required to provide certain information to a customer before the conclusion of an initial contract of insurance and, if necessary, when that contract is amended or renewed. Under ICOBS 4.1.2, this information must include:

exchange or clearing house. Other entities, such as local authorities or bodies corporate with minimum capitalisation of £10 million (or satisfying other tests), or a partnership or trust with net assets of £10 million may also be treated by a firm as an eligible counter-party provided that (a) they are advised in writing by the firm that they are being treated as an eligible counter-party, and that this implies the loss of protection under the regulatory system, and (b) no objection has been received. Lloyd's names who are individuals with unlimited liability may not be treated as eligible counter parties for the purpose of these principles.

37 Apart from those in controlling functions, this would include, for example, anyone in a management functions such as a senior manager with significant responsibility for the effecting by an insurer, or by a managing agent on behalf of a member of the Society of Lloyd's, of contracts of insurance other than contractually based investments.

38 ICOBS applies to firms carrying out insurance mediation activities; effecting and carrying out contracts of insurance; managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's or communicating or approving financial promotions, and connected activities.

(3) whether it has a direct or indirect holding representing more than 10% of the voting rights or capital in a given insurance undertaking (that is not a pure reinsurer);

(4) whether a given insurance undertaking (that is not a pure reinsurer) or its parent undertaking has a direct or indirect holding representing more than 10% of the voting rights or capital in the firm...

1.10 Under ICOBS 4.1.6, an insurance intermediary must at the same time tell its customer whether:

- (a) it gives advice on the basis of a fair analysis of the market; or
- (b) it is under a contractual obligation to conduct insurance mediation business exclusively with one or more insurance undertakings; or
- (c) it is not under a contractual obligation to conduct insurance mediation business exclusively with one or more insurance undertakings and does not give advice on the basis of a fair analysis of the market.

1.11 An insurance intermediary that does not advise on the basis of a fair analysis of the market must inform its customer that he has the right to request the name of each insurance undertaking with which the firm may and does conduct business. The intermediary is required to comply with such a request (ICOBS 4.1.6(2)).

Inducements

1.12 ICOBS 2.3.1 provides guidance on the application of the principles to the accepting and receiving of inducements:

- (1) Principle 8 requires a firm to manage conflicts of interest fairly, both between itself and its customers and between a customer and another client. This principle extends to soliciting or accepting inducements where this would conflict with a firm's duties to its customers. A firm that offers such inducements should consider whether doing so conflicts with its obligations under Principles 1 and 6 to act with integrity and treat customers fairly.
- (2) An inducement is a benefit offered to a firm, or any person acting on its behalf, with a view to that firm, or that person, adopting a particular course of action. This can include, but is not limited to, cash, cash equivalents, commission, goods, hospitality or training programmes.

Provisions applying specifically to Lloyd's

1.13 The FSA has imposed particular requirements on Lloyd's. Under INSPRU 8.2.6, managing agents are required "to establish and maintain adequate systems and controls to manage the risks to which the insurance business carried on through each syndicate it manages is exposed". In complying with this rule, they are required to have particular regard to—

- (1) "transactions which may give rise to a conflict of interest, such as those to which the counterparties are:
 - (a) other members of the managing agent's own group;
 - (b) any members of any syndicates managed by the managing agent; or
 - (c) any entity that is part of a group to which one or more members of any syndicates managed by the managing agent belong, and
- (2) transactions involving:
 - (a) the provision of capital;

- (b) the provision of reinsurance; or
- (c) the provision of other services.”

1.14 In addition, the Society is required to establish and maintain effective arrangements to monitor and manage risk arising from “conflicts of interest (including in relation to inter-syndicate transactions (including reinsurance to close and approved reinsurance to close,³⁹ related party transactions, and transactions between members and itself)” (INSPRU 8.2.11). This rule appears only to relate to transactions to which the Society is itself a party, so it will be of limited if any relevance in guarding against abuses arising out of conflicts of interest between names and underwriting agents.

Disciplinary sanctions

1.15 Breaching rules made under the Act (including the principles set out in the Handbook) makes a firm liable to disciplinary sanctions. Under section 205 of FSMA, the FSA may publish a statement that an authorised person has contravened a requirement imposed on him under the Act, exposing the person or firm concerned to public censure. Under section 206 of the Act, the FSA has the power to impose a financial penalty on any authorised person it considers has contravened a requirement imposed under the Act. The penalty may be “of such amount as [the FSA] considers appropriate”. It is not limited by the Act.

1.16 Breach of the principles or other rules may also trigger the FSA’s powers to vary (or withdraw) permission under Part IV of FSMA, if it leads the Authority to conclude that it is desirable to exercise that power to protect the interests of consumers, under section 45 of the Act.

1.17 Breach of the principles or other rules may also provide grounds for the FSA to apply to the court for an injunction under section 380 of the Act seeking an order restraining the contravention or requiring the person who has contravened a requirement laid down under the Act (or anyone else who appears to have been knowingly concerned in the contravention) to take such steps as the court may direct to remedy it.

Restitution and Injunctions

1.18 The FSA also has powers to apply to the Court for a restitution order under section 382 of the Act, where it can show that someone has contravened a requirement imposed under the Act (which include the principles laid down in the FSA handbook) and either that profits have accrued to him as a result of the contravention or that one or more persons have suffered loss or been otherwise adversely affected as a result of the contravention.

EU LAW ON INSURANCE INTERMEDIARIES

1.19 Council Directive 2002/92/EC on insurance mediation accepts that insurance undertakings may carry out insurance mediation activities: Insurance mediation is defined as—

“the activities of introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim”.

The definition goes on to note—

39 ““Approved reinsurance to close” excludes reinsurance between parties other than members; and balance transfers between syndicate years of syndicates having only one member, which have no effect on the overall liabilities of that member.”

“these activities when undertaken by an insurance undertaking or an employee of an insurance undertaking who is acting under the responsibility of the insurance undertaking shall not be considered as insurance mediation”.

They do not therefore require separate authorization.

1.20 The directive also provides for the authorization of tied-insurance intermediaries – those insurance agents carrying on the activity of insurance mediation for and on behalf of one or more insurance undertakings in the case of insurance products which are not in competition but does not collect premiums or amounts intended for the customer and who acts under the full responsibility of those insurance undertakings for the products which concern them respectively. Similar provisions apply in relation to reinsurance mediation.

1.21 Instead information requirements are imposed on insurance and reinsurance intermediaries. Under article 12, prior to the conclusion of any initial insurance contract, and, if necessary, upon amendment or renewal thereof, an insurance intermediary shall provide the customer with information including—

“whether he has a holding, direct or indirect, representing more than 10% of the voting rights or of the capital in a given insurance undertaking” (article 12(1)(c)) and

“whether a given insurance undertaking or parent undertaking of a given insurance undertaking has a holding, direct or indirect, representing more than 10% of the voting rights or of the capital in the insurance intermediary” (article 12(1)(d)).

1.22 The insurance intermediary must also inform the customer, concerning the contract that is provided, whether “he is under a contractual obligation to conduct insurance mediation business exclusively with one or more insurance undertakings” (and to provide the names of those undertakings on request); and, if he is not under such a contractual obligation, and does not give advice based on a fair analysis, he must at the customer’s request provide the names of the insurance undertakings with whom he does do business (and inform the customer of his right to request such information).

1.23 This information does not need to be provided where the insurance intermediary mediates in the insurance of large risks, or in the case of mediation by reinsurance intermediaries. (Article 12(4)). These provisions are implemented in UK law through the FSA Handbook, ICOBS 4.1.2 (see above).

Formal Minutes relating to the report

Tuesday 14 October 2008

Members present:

Andrew Miller, in the Chair

Lorely Burt
John Hemming

Judy Mallaber
Dr Doug Naysmith

Draft Report (Draft Legislative Reform (Lloyd's) Order 2008), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 38 read and agreed to.

Summary agreed to.

Several papers were ordered to be appended to the Report.

Resolved, That the Report be the Sixth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

[Adjourned till Tuesday 4 November at 9.30 am

Letter to the Regulatory Reform Committee from Cotesworth 535 / 536 Action Group

As Chairman of the Cotesworth Action Group [CAG], I am a listed consultation respondent to the proposed LRO.

In the July 2008 response to consultation document, our proposal is outlined in section 4.40, together with the Government response in 4.41-4.46, in which reasons are put forward as to why our proposal is not necessary.

The reasoning outlines the role of the Lloyd's Ombudsman and states that where members believe that they have suffered injustice in consequence of maladministration, the Lloyd's Ombudsman has substantial powers under the Members' Ombudsman 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.

However, the Government's response fails to point out that, under the Members' Ombudsman Byelaw, Lloyd's are not obliged to accept or implement the Ombudsman's recommendations and it is exactly this situation, where Lloyd's unreasonably fails to accept the recommendations of the Ombudsman, that we wish to address by way of our revised proposed amendment.

In situations where the Lloyd's Ombudsman had upheld a complaint by a member, or members, of Lloyd's against Lloyd's treatment of a Members Compensation Scheme [MCS] application, and Lloyd's decided to take no action to remedy the maladministration found by the Ombudsman, the member would have no right of appeal against Lloyd's decision, and no means of legal redress, however unreasonable, unjust or unfair Lloyd's decision.

Lloyd's sits, in effect, as judge and jury on cases where it has been found guilty of maladministration and is uniquely (for a private body) protected from suit and thus there is no appeal process available against a decision by Lloyd's, made by itself, about itself, even if Lloyd's is clearly in the wrong. In circumstances where Lloyd's disregards an Ombudsman finding of maladministration in relation to issues as serious as alleged dishonesty or fraud in the market, the Lloyd's member should have a right of suit against Lloyd's.

Our amendment is designed to prevent miscarriages of justice in relation to MCS applications. We have restricted the amendment to situations where Lloyd's fails to accept and implement the Lloyd's Ombudsman's findings in relation to a complaint about Lloyd's handling of an MCS application, since it is especially important that Lloyd's deals reasonably and fairly with MCS applications, because these applications, by definition, involve allegations that there has been dishonesty and / or fraud in the Lloyd's market.

The present situation allows Lloyd's to ignore with impunity the findings of the Ombudsman in such cases. Our proposed amendment would therefore reduce the likelihood that Lloyd's members would be deterred from investigating and presenting an MCS claim (for losses suffered as a result of dishonesty, want of probity or fraud), by the fact that, even if the Ombudsman found that Lloyd's had treated their claim unfairly and recommended that Lloyd's compensate them or not impose a prohibitive litigation requirement, Lloyd's could, with impunity, ignore such recommendations and thereby prevent applicants receiving compensation or a finding being made that there had been dishonesty or fraud at Lloyd's.

Our amendment would introduce an additional, very limited exception to the immunity from suit under the Lloyd's Act 1982 – Lloyd's is already open to suit for libel, slander, personal injury and breaches of Human Rights legislation. The exception to immunity would only apply to any decisions taken by Lloyd's after the LRO became Law, and so would not be retrospective.

Our precise proposal is that there should be an amendment to clause 14(3)(e) of the Lloyd's Act 1982, in the form of a new (iii), providing other, very limited, exception to the immunity from suit, if "the act or omission complained of (the wording in the Act)

“or (iii) was a failure to accept and / or implement reasonable findings and / or recommendations of the Lloyd's Ombudsman in relation to a complaint about the maladministration by Lloyd's of an application to the Lloyd's Members Compensation Scheme.”

The Government raised three principal objections in relation to our original amendment:

- (a) that the amendment would have retrospective effect
- (b) that there were “non-legislative means of securing [our] objective”
- (c) that the “Society would be required to devote significant resources both in terms of cost and management time) to contesting such claims [that the Society had failed to handle MCS applications reasonably and fairly)]”

Our revised amendment is not subject to any of these objections because

- (i) it is not retrospective
- (ii) there are no non-legislative means of dealing with a failure by Lloyd's to accept and implement recommendations of the Ombudsman in relation to Lloyd's maladministration of an MCS application
- (iii) MCS applications are very rare – only two substantial applications in twenty years—so instances where the Ombudsman found that an application to the MCS had been maladministered by Lloyd's, and Lloyd's then failed to accept and implement the Ombudsman's recommendations in relation to that maladministration, should be very much rarer still. Indeed, they *ought not* to occur at all. The prospective waste of Lloyd's time and resources is therefore not a relevant consideration.

Furthermore, Lloyd's does not need protecting from the possibility that Lloyd's *might choose* to incur the costs of contesting a claim based on its failure to implement the Ombudsman's reasonable recommendations, rather than actually implementing those recommendations. Our revised amendment could not therefore be said to contravene section 3(2) (d) of the Legislative and Regulatory Reform Act 2006 [LRRRA] (as the Government said our original amendment appeared to do.)

The Government also said that it is “not entirely clear how [our previous] amendment can be said to “reduce or remove a burden with the meaning of section 1(3) of the 2006 Act.” Our revised amendment clearly does remove such a burden for the following reasons:

The definition of a burden in the Act includes, according to the Treasury March LRO proposal, both a ‘financial cost’ and an ‘obstacle to efficiency, productivity or profitability.’

Applications to the MCS, and complaints to the Ombudsman about the treatment of such applications, are likely to be expensive undertakings. If Lloyd's were to disregard and/or fail to implement the findings of the Ombudsman that it had maladministered an application to the MCS, all the financial cost of applicants to the MCS would be wasted. More generally, the *efficiency* of any appeal process is compromised if the findings of the appeal can be ignored with legal impunity and successful appellants thereby prevented from receiving any compensation for the injustice they have been found to have suffered, or even for the costs of the appeal process.

Moreover, the absence of any available legal redress for MCS applicants in a situation where Lloyd's failed to accept a finding, or implement recommendations by the Ombudsman in relation to an application alleging that there had been dishonesty or fraud in the market, compromises the efficiency and effectiveness of *regulation* in the Lloyd's market, and effective regulation is a factor that contributes indirectly to the profitability of the market, because it enhances confidence in that market.

Regrettably, there is currently an apprehension among many underwriting members that Lloyd's *might* ignore reasonable recommendations by the Ombudsman in relation to an MCS application. This apprehension has arisen for two principal reasons.

First, Lloyd's views the existing MCS as providing discretion for them to require applicants to litigate against agency individuals as a means of proving their claims against an agent, and Lloyd's recent draft proposals for a future MCS propose that such a requirement should be the norm rather than the exception.

MCS applications are (to be) determined by a ‘Panel.’ The “guidance” as to what that Panel should take into consideration when deciding whether or not to make an exception to the rule of required litigation, does not include the affordability of that litigation. *Prima facie*, the affordability of an application is a basic and highly relevant consideration for a compensation scheme designed to provide investor protection for individual underwriting members of Lloyd’s, as part of the regulatory framework.

Lloyd’s have acknowledged that this was the intention of the Scheme, for in a consultation document issued in August 2007, they stated that:

“the [MCS] Scheme was implemented as a consequence of a recommendation in the 1986 report of the committee of enquiry into the regulatory arrangements at Lloyd’s chaired by Sir Patrick Neill QC. The Neill report stated that:

Names should have at least the same degree of protection as will be available to investors’ in general under the SIB ‘s compensation scheme [the SIB was the forerunner of the FSA]’.”

However, unless our amendment is incorporated, Lloyd’s recent proposals could frustrate the purpose of the scheme, because a requirement to litigate would make it far more difficult for applicants to obtain redress for dishonesty or fraud or want of probity. than if the Agent had remained solvent.

By virtue of their contracts with underwriting agents, underwriting members are both required, and able, to bring claims against underwriting agents under Lloyd’s Arbitration Scheme. A single individual, or a small group of individuals, can bring a claim for dishonesty or fraud provided the claim(s) do not exceed £100k. A single individual, or a small group of individuals, could not possibly afford to secure a Court judgment as a precursor to obtaining compensation. Unless “affordability” is regarded as a legitimate consideration in a decision about whether or not to impose a litigation requirement, individuals or small groups, could only obtain compensation for dishonesty or fraud if their agent remained solvent. But this would defeat the purpose of the MCS which is to provide a route for compensation for such claims *if the agent is insolvent or otherwise unable to pay.*

The situation would not be much better for larger action groups with a larger total of individual claims, because Lloyd’s recent MCS proposals state that a default judgment against the agent would not be acceptable. MCS applicants would therefore be obliged to obtain a judgment against an agency individual or individuals, as a proxy for a judgment against the agent itself. In cases (like the CAG’s), where it is unclear which agency individual would be held to have caused them loss from dishonesty or fraud, applicants would be obliged not only to sue a number of individuals rather than a single agent, but would also have to overcome the legal difficulties that arise in relation to suits against agency individuals (with whom applicants have no contract) and which do not arise in suits against an agent (with whom all potential applicants would have contracts.) The extra costs and risks would in most cases render litigation unaffordable even for larger groups of potential MCS applicants.

In practice, therefore, MCS applications, however strong the claims on which they are based, are extremely unlikely to be pursued unless the requirement to litigate is removed or waived.

In these circumstances, the Ombudsman might well take a different view from Lloyd’s as to whether it was appropriate to exclude affordability as a consideration relevant to the crucial issue of whether or not a litigation requirement should be imposed. There is therefore considerable room for disagreement between Lloyd’s and the Ombudsman as to the situations in which an exception to the litigation rule should be made.

Potential applicants would need to have confidence that in the event of such a disagreement, Lloyd’s could not simply ignore the recommendations of the Ombudsman, without the applicant at least having the right of appeal to a Court. Without such a right, it is very doubtful if any application to the scheme will ever be made in the future, however strong the applicant, or applicants’ case, and the intention of the scheme to provide to underwriting members “at least the same degree of protection as will be available to investors in general,” will be wholly frustrated.

In this context, it should be noted that it is not just the GAG which considers that a requirement to litigate would prevent any application being made to the MCS, or being pursued once made. An article in the most recent edition of the ALM News (a bi-monthly Newsletter for independent capital providers at Lloyd's) argues that a litigation requirement would constitute

“a huge deterrent to [Lloyd's members] seeking compensation for dishonesty against a bust agent” and that

“no claim under the MCS will ever be made by a responsible Action Group in future if a requirement to litigate against the directors [of an underwriting agency] is imposed.”

What applies to an action group, obviously applies *a fortiori* to an individual, or a small group of individuals.

Secondly, the judgment in the 2003 *Stirling Cooke Brown* case gives rise to a reasonable apprehension that Lloyd's might wish to minimise the likelihood of there being a finding that there had been dishonesty or fraud at Lloyd's, for in this case, where the judge found that a Lloyd's underwriter had been dishonest, Lloyd's was criticised in the judgment for failing to comply with the Court's request to provide the Court with documents in its possession or to give any reason for that failure—the judge had to reach the finding of dishonesty without the benefit of the documents requested from Lloyd's.

A situation where Lloyd's could with legal impunity ignore a reasonable finding by the Ombudsman that Lloyd's had exercised their discretion unreasonably or unfairly to impose an onerous litigation requirement on MCS applicants constitutes a deterrent to any MCS application being made, and to the investigation of potential dishonesty or fraud or want of probity that would necessarily have to precede any MCS application.

Where investigation is less likely, transgression is more likely to occur. *Efficient and effective* regulation should increase, rather than decrease, the deterrence to dishonesty and fraud in the market.

The incorporation of our proposed amendment is therefore also justified under Section 2 of the LRRRA in which a minister can make a Legislative Reform order “for the purpose of securing that regulatory activities should be carried out in a way that is transparent, accountable, proportionate, consistent” and “targeted only at cases in which action is needed.”

Our proposed measure will achieve that very purpose, because it will provide a disincentive to Lloyd's to disregard reasonable findings and recommendations of the Ombudsman in relation to maladministration of an MCS application that seeks redress for dishonesty and fraud in the market (when that redress would not otherwise be available because the agent is unable to pay.)

As observed above, the MCS was introduced as a result of Sir Patrick Neill's review of the “regulatory arrangements at Lloyd's.” Our proposed amendment would both reduce a burden on individual members who consider that they have grounds to make such an MCS application, and enhance the effectiveness of regulation in the market. As such, our proposed amendment would serve both the interests of individual members of Lloyd's and have public policy benefits, for it is in the public interest that there be the utmost confidence in the integrity and regulation of financial markets of which Lloyd's is a significant part. There are therefore no grounds for considering that our revised amendment would contravene any part of Section 3 of the LRRRA.

Further, there is no good reason why our revised amendment should be regarded as “highly controversial.” Lloyd's has very recently acknowledged, in its 26 August 2008 proposals for the future MCS scheme, that the MCS “helps promote overall confidence in the market.” If Lloyd's were to argue that it needed to retain the right to ignore with legal impunity reasonable findings or recommendations by the Ombudsman that it had maladministered an MCS application, that would undermine confidence in the market, for a crucial ingredient in the trust and confidence in any financial market is that there will not be barriers or disincentives to the investigation of dishonesty or fraud.

I therefore hope that you will support this proposed amendment, which has been revised in the light of the Government's comments, and the very recent (26 August) Lloyd's proposals for the future of the MCS.

31 August 2008

Submission to the Regulatory Reform Committee from Julian West (Lloyd's Name)

- 1). The Lloyd's Act was presented to parliament as a private bill, to which there is a general right of objection by way of petition to parliament, and after enactment became a local Act. Such Acts are required to be strictly construed and, by the same token, the LLRA must also be strictly construed when used to amend such Acts..

- 2). The reforms to the Council and the abolition of the Committee listed in proposals 1, 2 & 4 (Articles 3, 4 & 5 of the LRO), comprise significant changes to the constitution of Lloyd's. These particular reforms are both clearly and self evidently of constitutional significance for the Society, and therefore may not be the subject of a Legislative Reform Order (see LLRA Subsection 3(2)(f)* below). The changes to the voting arrangements, entitlement to election, and the abolition of the Committee and of its responsibilities listed in proposals 1, 2 & 4 (Articles 3, 4 & 5 of the LRO) are all significant changes to the constitution of Lloyd's. In spite of this, in sections 2.5 and 3.53 of the LRO consultation response it is stated that:- "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 and hence satisfy Subsection 3(2)(f) of the 2006 Act.", and "Nor does the government consider that these proposals make fundamental changes to the constitution of Lloyd's". However, the Act only requires that "the provision is not of constitutional significance". This requirement, expressis verbis, is not limited either to "the constitution of this country" or to "fundamental changes", but includes within its ambit any changes of "constitutional significance" for Lloyd's. The government's conclusion that proposals 1, 2 & 4 (Articles 3, 4 & 5 of the LRO) satisfy Section 3(2)(f) of the 2006 Act, is therefore incorrect in law.

- 3). The reforms to the Council and the abolition of the Committee in proposals 1, 2 & 4 (Articles 3, 4 & 5 of the LRO) do not meet the requirements of either Section 1(1) or 2(1) of the Legislative Reform Act, in that they do not discernibly reduce any burden as defined in Section 1(3) of the LLRA, or relate to regulatory functions as defined by Section 2(2) of the LLRA, and are therefore not allowable.

- 4). Given the constitutional nature of the reforms listed in Articles 3, 4 & 5 of the LRO (consultation proposals 1, 2 & 4), the Super-Affirmative Resolution Procedure would appear to be necessary in this case. Presumably the appropriate procedure is to be decided by the Committees themselves, rather than by the Treasury.

*The LLRA Subsections 3(1) and (2)(f) state:-

3 Preconditions

- (1) A minister may not make provision under section 1(1) or 2(1), other than a provision which merely restates an enactment, unless he considers that the conditions in subsection (2), where relevant, are satisfied in relation to that provision.

- (2) These conditions are that - (f) the provision is not of constitutional significance.

19 September 2008

List of Reports from the Committee during the current Parliament

Session 2007-08

First	Draft Legislative Reform (Local Authority Consent Requirements) (England and Wales) Order 2007	HC 135
Second	Draft Legislative Reform (Health and Safety Executive) Order 2008	HC 398
Third	Draft Legislative Reform (Consumer Credit) Order 2008	HC 939
Fourth	Draft Legislative Reform (Local Authority Consent Requirements) (England and Wales) Order 2008	HC 940
Fifth	Getting Results: the Better Regulation Executive and the Impact of the Regulatory Reform Agenda	HC 474-I and II

Session 2006-07

First Special	Scrutiny of Regulatory Reform Orders	HC 160
Second Special	Revised Standing Orders	HC 385
First	Proposal for the Regulatory Reform (Game) Order 2007	HC 384
Second	Proposal for the Regulatory Reform (Collaboration etc between Ombudsmen) Order 2007	HC 383
Third	Proposal for the Regulatory Reform (Financial Services and Markets Act 2000) Order 2007	HC 397
Fourth	Proposal for the Regulatory Reform (Deer) (England and Wales) Order 2007	HC 411
Fifth	Draft Regulatory Reform (Collaboration etc. between Ombudsmen) Order 2007	HC 611
Sixth	Draft Regulatory Reform (Financial Services and Markets Act 2000) Order 2007	HC 673
Seventh	Draft Regulatory Reform (Game) Order 2007	HC 674
Eighth	Draft Regulatory Reform (Deer) (England and Wales) Order 2007	HC 948