Proposals for a Legislative Reform Order to amend Lloyd's Act 1982:

response to consultation

July 2008

HM TREASURY

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Contents

		Page
Chapter 1	Introduction	3
Chapter 2	Overview of responses	5
Chapter 3	Specific comments	7
Chapter 4	Additions to the draft Order suggested by respondents	17
Chapter 5	Next steps	27
Annex A	List of consultation respondents	29

1 Introduction

1.1 In June 2007, the Government announced[1] that it would bring forward proposals for an Order under the Legislative and Regulatory Reform Act 2006 (the 2006 Act) to modernise the governance arrangements at Lloyd's, update and streamline Lloyd's governance procedures, and remove unnecessary restrictions on how Lloyd's organises its affairs. The aim of the Legislative Reform Order (LRO) was to complement the market reforms Lloyd's is already pursuing to modernise and update its market processes, and help Lloyd's to maintain its competitiveness.

1.2 The Treasury issued its proposals for the LRO in the Spring. In line with the purposes of the 2006 Act, the focus of the proposals was highly practical. No amendments were suggested to the fundamental constitutional aspects of Lloyd's current governance arrangements, such as rules on members' voting rights.

1.3 The Treasury proposed eight reforms. In relation to governance arrangements, the Treasury proposed to:

- relax the rule requiring the Chairman and Deputy Chairmen to be working members, so that these posts may be filled by any member of the Council, provided always that one of the Chairman and Deputy Chairman is a working member;
- remove restrictions on elections to the Council affecting working members, to permit more flexibility and greater alignment with the Combined Code;
- remove the requirement for the Governor of the Bank of England to approve appointments of nominated members of Council, as this duplicates the Financial Services Authority's approval process;
- remove the provisions relating to the Committee of Lloyd's;
- modernise and streamline the Council's delegation powers, while preserving the Council's existing reserved powers;
- ease restrictions on the composition of Disciplinary Committees.

1.4 In relation to the market, the Treasury proposed to:-

- remove the restriction that requires managing agents generally to accept business only from a Lloyd's broker, while retaining the class of "Lloyd's broker" for brokers that want to bear the title of "Lloyd's broker"; and
- remove the divestment provisions (which prohibit prescribed associations between Lloyd's brokers and managing agents), in favour of a new mechanism, consistent with the Financial Services Authority's regulatory requirements, which will allow the Society to monitor potential conflicts of interest between managing agents and associated brokers, and provide transparency on such associations to members.

[1] Written Ministerial Statement (OR 21/6/2007 Col 105WS)

Consultation process

1.5 The consultation ran for three months, from 7 March 2008 until 30 May 2008. At the start of the consultation, the Chairman of Lloyd's wrote to all members of the Society, drawing their attention to the consultation proposals and to how they could make their views known. Separately, HM Treasury sent a letter to 258 individuals and organisations, including all Lloyd's brokers and underwriters, to the main market representative organisations, and to individuals who had expressed an interest in the consultation exercise.

1.6 During the consultation period, Treasury officials held a series of meetings with individuals and representative organisations with a particular interest in the content of the LRO. These included meetings with members and members' groups, with the Lloyd's Market Association (LMA) and managing agents, the London Market Insurance Brokers Committee (LMBC) and Lloyd's brokers, and members' agents and advisers.

1.7 The Society of Lloyd's held an Extraordinary General Meeting of the Society on 21 May 2008, to give members an opportunity to discuss the proposals and express their views. The meeting was invited to vote on the following resolution:-

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

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

Government's response

1.8 The Government is very grateful to those who responded to the consultation document in writing and/or who contributed in meetings as part of the consultation process. The comments received have informed the Government's approach to the proposals in the consultation document.

1.9 Chapter 2 of this document summarises the comments made on the consultation proposals and the Government's response to these. Chapter 3 discusses specific points made by respondents, and Chapter 4 the additional reforms that respondents suggested should be included in the draft Order. Chapter 5 sets out the next steps in respect of the Legislative Reform Order, and Annex A lists the respondents to the consultation.

2 OVERVIEW OF RESPONSES

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

2.2 Some respondents commented in relation to all or most of the proposals included in the draft Order. Others commented only in relation to one or more of the proposals. The level of support expressed for each of the proposals by those commenting on that proposal is set out in the table below. Of all the proposals, the market reforms (Nos 7 – 8) attracted the most comment; however there were also many comments on the governance reforms (Nos 1 – 6), particularly the first two.

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

2.3 Three of the 66 respondents argued that the proposed Order was an inappropriate use of the powers under the 2006 Act. These respondents expressed concern that the draft Order was being used to make significant amendments to a local Act that had first been introduced into Parliament as a private Bill following an extensive process of consultation with the membership, and that had been passed after full discussion in Parliament. It was noted that, in contrast to a private Bill, there is no right of objection by way of petition to Parliament to an order under the 2006 Act. These responses also criticised the Treasury consultation as being insufficient.

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

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

2.6 Suggested additions to the proposed LRO were received from 20 respondents. 11 of these were individual Lloyd's members who made no comment on the Government's proposed reforms but sent in identical letters of support for a set of proposals made by Lloyd's Name. The Government does not believe that any of these additional proposals can be included in the LRO, either because they cannot be shown to remove or reduce a burden resulting from the legislation governing Lloyd's, or because they do not comply with the preconditions which must be satisfied under section 3 of the Legislative and Regulatory Reform Act 2006. The suggested additions, and the Government's response to these, are set out in Chapter 4.

Conclusion

2.7 On the basis of the overall response to the consultation exercise, the Government has decided to take forward all eight of the proposals originally set out in the consultation document, with one minor modification in relation to proposal 2.

2.8 The next Chapter summarises the specific comments made on the Government's proposals and on the proposed parliamentary procedure. The information in this Chapter is extracted from the full Explanatory Document, which has been laid with the draft Order before Parliament, and which is published separately on the Treasury's website.

3 Specific comments

The governance reforms

1. The Chairman and Deputy Chairmen of Lloyd's

Proposal **3.1** Concerning the Chairman and Deputy Chairmen of Lloyd's, the Government's proposal was to

- **Amend section 4 of Lloyd's Act 1982 so that the Council can elect any of its members as Chairman or Deputy Chairmen.**

At the same time, it was proposed that the draft Order should

- **Stipulate that in future the Council should elect its Chairmen and Deputy Chairmen by special resolution and**
- **State that, if the Chairman is not a working member of the Council, at least one Deputy Chairman of Lloyd's must be a working member of Council.**

Comments Received **3.2** Out of the 41 respondents that considered this proposal, 38 (93%) were in favour, 1 (2%) had reservations and 2 (5%) objected. Eleven of the written responses that commented specifically on this proposal gave unreserved support, with several noting the importance of Lloyd's being able to choose its management from as broad a group as possible.

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

3.4 The Association of Lloyd's Members, while supporting the reform, suggested that it was important to ensure that only one of the Chairman and Deputy Chairmen was not a working member; while one of the members' agents suggested that it would be preferable if Lloyd's maintained an even ratio (2:2) among the four posts of Chairman/Deputy Chairman and senior nominated member of Council. One corporate member suggested in its response that the election of the Chairman by the special resolution procedure was unnecessary.

Objections **3.5** Those objecting to the proposal disagreed with the Government's assessment that the change was necessary, or suggested that the reforms would not reduce a burden. One argued that Lloyd's experience showed that it was possible to find a "work-around" to recruit external candidates to the role of Chairman. However, as explained in the consultation, the Government believes that the current requirement constitutes an unnecessary burden on the Society. Most respondents agreed with this view.

Government's Response **3.6** In relation to the requirements concerning the Deputy Chairmen, the Government believes the proposal made in the LRO provides the right result and that setting alternative ratios or limits in statute would be too prescriptive. Lloyd's will be able to limit the terms which may be served by anyone holding a particular position by byelaw if this is seen to be appropriate. In addition, the slight tightening of the election procedure is a proportionate measure which will ensure that no necessary protections are removed for working members in particular by relaxation of the Section 4 rule.

2. Elections to the Council of Lloyd's

Proposal **3.7** The Government's proposal was to **remove restrictions on elections to create greater flexibility and to permit greater alignment with the Combined Code on Corporate Governance**. The Government specifically sought views from respondents on whether any statutory limit on the Chairman's term of office was necessary and, if so, what the limit should be.

Comments Received **3.8** Of the 44 respondents that commented specifically on this proposal, 39 (89%) were in principle in favour of a relaxation of the rules on elections to Council, 2 (4%) expressed reservations and 3 (7%) were against.

Objections **3.9** One of the objectors stated that this provision was an important protection for investors, preventing a minority of working names exercising undue influence. The others felt that the case for the change had not been made. The Government does not consider that this proposal will remove a necessary protection for members of the Society since if a majority of the working members of the Society believe that a particular member should not stand for a further term, they will be able to prevent this by voting for another candidate. The Chairman and Deputy Chairman must also stand for annual election by Council members under section 4 of Lloyd's Act 1982, if they are to retain their positions.

Comments on consultation question 1.14 **3.10** Only 14 respondents commented on the question posed by the Government in paragraph 1.14 of the Consultation Paper. Opinion was divided as to whether there should be a statutory restriction on the maximum number of years in aggregate that a member of Council can serve as Chairman, and if so what that limit should be.

3.11 The argument against any statutory restriction (put most strongly by the Council of Lloyd's and also by the Association of Lloyd's Members) was that the matter should be left to the Council to regulate by byelaw. This would allow flexibility, if the rules needed to be adjusted again in future to keep in step with generally accepted standards of good governance. Support for this position also came from 3 other respondents, one of whom felt that there should be no restriction, subject to the normal expectations of disclosure (i.e. that Lloyd's should be expected to comply with the Code on Corporate Governance and to explain where the Code is not being followed).

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

Government's Response **3.13** In the light of the consultation, the Government believes the best solution would be to remove all statutory restrictions. In absence of such restrictions, however, the Government's view is that Lloyd's byelaws should match current standards of good corporate governance. The Council of Lloyd's has publicly committed to good corporate governance and supports the application of the Combined Code on Corporate Governance, as far as this can be applied to the governance of a Society of members and a market of separate competing entities[2].

[2] See page 87 of Lloyd's Annual Report 2007

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

3. The Governor of the Bank of England etc

Proposal

3.15 The Government's proposal was to **remove the requirement for approval from the Governor of the Bank of England for the appointment of nominated members of the Council.**

Comments received

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

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

3.18 The Government believes the question of suitability of particular nominated members is primarily for Lloyd's. Similarly, the issue of transparency regarding the workings of NACC is a matter for Lloyd's.

4. The Committee of Lloyd's

Proposal

3.19 The Government's proposal was to **remove the provisions establishing the Committee of Lloyd's** since the Committee is now little used.

Comments Received

3.20 Of the 41 respondents who considered this proposal, 39 (95%) were in favour and 2 (5%) objected, on the grounds that the proposal was unnecessary, or that it did not remove a burden. One respondent, while recording support, suggested that the working member constituency included some kinds of practitioner expertise, which were not reflected in the current composition of the Franchise Board and that including such expertise would be beneficial for Lloyd's/Franchise Board.

Government's Response

3.21 The Government notes the concerns expressed above but believes that the composition of the Franchise Board is a matter for Lloyd's. In the same way that the Council can (if it wishes) establish a committee composed solely of working members, there is nothing to prevent the Council adjusting the make up of the Franchise Board if this is felt to be desirable.

5. Delegation

Proposal **3.22** The Government's proposal was to **reform the delegation rules and remodel them along the lines of powers of delegation given to the Boards of major companies, subject to preserving the Council's reserved powers.**

Comments received **3.23** Of the 43 respondents who considered this proposal, 41 (95%) were in favour and 2 (5%) objected. Two of those endorsing the proposal particularly welcomed the fact that the Council's reserved powers were not being disturbed, while a past member of the Council of Lloyd's noted that he attached particular importance to the need to adapt the current provisions on the powers of delegation of the Council so that they are more closely aligned with practice in major corporate boards.

Objections **3.24** One respondent objected to the proposal because he felt this reform would weaken the Council's control over decision making. Another respondent objected on the grounds that the new delegation rules will be more arbitrary, that they lack the requirement for ratification contained in the old provisions, and that they do not contain a requirement for delegations and sub-delegations made under these provisions to be made a matter of public record. The Government notes that the provisions in the 1982 Act do not require delegations made under them to be published, and such a requirement is not commonly incorporated into powers of delegation in relation to other corporate bodies. Any delegation or grant of a power to sub-delegate must be made by the Council by special resolution; and all members of the Council will therefore have the opportunity to be party to the decision and will be able to ask the Council to consider delegations made at subsequent Council meetings. It is not therefore necessary to include the ratification provisions from section 6(8) of the 1982 Act which were intended to ensure that regulations made by the Committee in the exercise of powers delegated to it could be subjected to scrutiny by the Council.

6. Disciplinary Committees

Proposal **3.25** The Government's proposal was to **relax the rules on the membership of Lloyd's Disciplinary Committees.** The requirement that a majority of the members of the Disciplinary Committees would be removed, with a safeguard instead included to ensure that the committees contained a member with practical experience and expertise in the market.

Comments received **3.26** Of the 41 respondents who considered this proposal, 39 (95%) were in favour and 2 (5%) objected. Among those in favour, one respondent noted that "increasing the scope for bringing external members on to disciplinary committees will also bring Lloyd's into line with the practice in other markets and professional bodies". Another respondent also welcomed the fact that this would make it easier to ensure the disciplinary committees included high quality, practicing lawyers.

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

reform only sets a minimum requirement, it will in any case be open to Lloyd's to ensure a suitable staffing of panels for any individual case.

Objections **3.28** The main objection to this proposal was from a member who felt that the traditional arrangements were preferable on principle because members should be "judged by their peers". The Government has framed its proposals to ensure an element of peer review continues; however, it believes other considerations mean that more flexibility is now needed to incorporate other expertise.

THE MARKET-RELATED REFORMS

7. Access to the Lloyd's market

Proposal **3.29** The Government's proposal was to remove the **restriction at section 8(3) Lloyd's Act 1982 that requires managing agents generally to accept or place business only from or through a Lloyd's broker.** At the same time, reflecting the need to preserve quality intermediation, the Government also proposed amending Schedule 2 to Lloyd's Act 1982 to confirm the Council has power:

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

Comments received **3.30** The proposed reform of section 8(3) generated the most interest and debate during the consultation. It also generated the most substantive responses.

3.31 Of the 48 respondents who considered the proposal, 38 (79%) were in favour, 2 (4%) expressed reservations and 8 (17%) objected. Those in favour of the proposal included the Society of Lloyd's; the Association of Lloyd's Members; the City Corporation; the Lloyd's Market Association, several individual underwriters and underwriting firms, the Institute of Insurance Brokers; three members' agents; and four senior City advisory firms. These respondents recognised the benefits that deregulation could bring, and the potential for efficiencies and cost savings, for example as can be seen in the quote below:

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

3.32 Feedback from Lloyd's brokers was more mixed. At the start of the consultation period, a number of brokers read the proposals as indicating that the reform was intended to allow brokers who would not meet the same prudential standards as Lloyd's brokers to access the market.[3] They felt this would lead to lower market

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

standards and would be a detriment to the market. The brokers also felt strongly that the costings provided in the consultation document's partial impact assessment in support of the proposal were incomplete and potentially very misleading.

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

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

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

3.34 However, six responses were received from brokers, and two from individuals, objecting to the proposals. These six included a mix of larger and smaller broking firms[4]. The brokers rehearsed a number of arguments, including strong concerns about the costings offered in the proposed impact assessment. A summary of the concerns is set out below, grouped thematically, with the Government's response. The issue of costings is covered at paragraph 3.41 and in the final impact assessment.

Objections and Government's response

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

3.35 The brokers suggested that the existing non-broker routes to the market which the Council has approved, demonstrates that the 1982 Act already has sufficient flexibility. One of the individual respondents also objected on this ground. However, the Government believes that section 8(3) is a restrictive provision and that it is therefore a barrier to further change.

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

3.36 The second argument made by brokers was that opening up the market would put Lloyd's at risk from poorly regulated or maverick brokers and that business generated from such brokers, or poorly handled business direct from insureds, could increase Lloyd's exposure to financial crime and /or damage the Lloyd's brand. It was also suggested by the other individual respondent that abolition of any distinction between Lloyd's and non-Lloyd's brokers will lead to market confusion at the consumer level. The brokers' concern has now been largely answered by Lloyd's confirmation that it intends to recommend the introduction of a byelaw, which will require the same prudential standards from non-Lloyd's brokers as from Lloyd's brokers. This will ensure that they meet the standards necessary for dealing with the more complex kinds

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

of business typically dealt with in the Lloyd's market. Permission to use the title "Lloyd's broker" will continue to be controlled by Lloyd's, and the Government does not therefore consider that the reform will lead to confusion.

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

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

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

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

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

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

(v) Costing the proposal

3.41 Nearly all the brokers were concerned by the estimated cost savings from this proposal that were set out in the partial impact assessment to the consultation. Three of those who had expressed a neutral position or positive position (including the LMBC) also objected to the costing. The Government has considered the arguments on the costing and has therefore revised the costs analysis. The revised analysis is set out in the full impact assessment which is published in the Explanatory Document on the Treasury website. This takes account of the submissions made by brokers but also reflects the view, put by those in favour of the reform, that the repeal of section 8(3)

should bring real benefits in the medium term, though the quantum of any immediate cost saving is hard to determine.

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

Divestment

Proposal

3.43 The Government's proposal was to **repeal the divestment rules**, that is, sections 10 to 12 of Lloyd's Act 1982 which prohibit associations between Lloyd's brokers and managing agents. **At the same time, a new disclosure mechanism would be introduced**, applying to managing agents, to ensure pre- and post-transaction transparency and allow the Society and individual members of Lloyd's to monitor potential conflicts between managing agents and brokers. The mechanism would include obligations imposed by byelaw, which would be subject to consultation by Lloyd's in accordance with FSA rules and, in turn reviewed by the FSA.

3.44 During the consultation, a number of requests were made for greater clarity on the proposed disclosure mechanism. Lloyd's has, as a result, confirmed that the disclosure mechanism will include a requirement for managing agents to specify in their syndicate business plans information relating to associations or underwriting transactions which may give rise to a conflict of interest, and to make a statement confirming that they have systems and controls in place for dealing with related parties in order to ensure that any conflicts of interest are managed fairly in accordance with applicable Lloyd's and FSA requirements. Lloyd's will introduce requirements as to the appropriate conflict management rules which must be adopted. Byelaws implementing these proposals will be subject to full consultation with the FSA and those who operate in the Lloyd's market.

Comments Received

3.45 Of the 45 respondents who considered this proposal, 40 (89%) were in favour, 1 (2%) expressed reservations and 4 (9%) were against. Of the 40 who welcomed this proposal, 15 offered more detailed comments, in particular:

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

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

Objections

3.47 Two respondents also made strong objections to the proposed reform, one on the grounds that the proposal placed too much reliance on the FSA's capacity to monitor potential conflicts; and the other on the grounds that it was not an appropriate

use of an LRO to repeal detailed provisions which had been the subject of considerable debate in Parliament when introduced in 1982.

Government's response

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

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

PARLIAMENTARY PROCEDURE

Proposal

3.50 The consultation document noted (at Annex C) that three alternative procedures for Parliamentary Scrutiny of the Legislative Reform Order were possible. These were:

- **negative resolution procedure** which allows Parliament 40 days to scrutinise a draft LRO, after which it can be made if neither House of Parliament has resolved during that period that it should not be made;
- **affirmative resolution procedure** which allows Parliament 40 days to scrutinise a draft LRO, after which it can be made it is approved by a resolution of each House of Parliament: and,
- **super-affirmative resolution procedure** which allows Parliament an initial 60 days of scrutiny of a draft LRO during which (written and/or oral) evidence can be required. After the 60 days, the Parliamentary Committees scrutinising the LRO make a report on the LRO and the Minister considers whether he/she wishes to make any changes as a consequence. After a further 15 (if the LRO is unchanged) or 25 (if the LRO is changed) day scrutiny period, the LRO can be made, but only if it is approved by a resolution of each House of Parliament.

3.51 The consultation document noted that whilst it was for the Government to recommend which method the Committees should adopt, the final decision rested with the Committees themselves. The Government recommended that the affirmative resolution procedure should be used because, although the LRO was not complex, and is limited in its effects to the Society of Lloyd's and those working in the Lloyd's market, this was the first time on which an order under the 2006 Act is being used to amend a local Act. It therefore seemed appropriate for the LRO to receive a degree of Parliamentary scrutiny greater than that which would be available under the negative

resolution procedure. However, the Government also noted that, since the LRO did not contain any proposals of wider political or public importance, there was little justification for the use of the super affirmative procedure. Comments were invited from respondents on this analysis.

Comments Received

3.52 Most respondents did not express a view on which Parliamentary Procedure was appropriate. Of those who did, 11 (85%) favoured the use of the affirmative resolution procedure and 2 (15%) the super-affirmative resolution procedure. One of these respondents favoured the super-affirmative procedure on the basis of his desire for the LRO to be amended to include the additional provisions, suggested in his response (see next Chapter). The other respondent argued that the super affirmative procedure should be used because of the constitutional nature of some of the Government's proposals.

Government's Response

3.53 The Government believes that it is not possible to include any of the additional proposals in the LRO, and that none of the proposals are of constitutional significance to this country. Nor does the Government consider that these proposals make fundamental changes to the constitution of Lloyd's. Accordingly, the Government remains of the view that the draft Order should be subject to the affirmative procedure. The Government notes that the affirmative resolution procedure provides opportunities for Parliament to scrutinise and debate the LRO and continues to believe that this is the most appropriate way of proceeding.

Conclusion

3.54 In the light of the above, the Government believes there is sufficient support for the proposals, and that the draft Order should therefore be taken forward.

4 ADDITIONS TO THE DRAFT ORDER SUGGESTED BY RESPONDENTS

4.1 This Chapter deals with those responses to the consultation that contained suggested additions to the draft Order.

4.2 As noted in Chapter 2, twenty respondents suggested other reforms for inclusion in the draft Order.

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

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

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

ADDITIONAL PROPOSALS

4.6 The specific proposals made by respondents were as follows.

Eliminate the distinction between working and external members

Proposal

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

Government's response

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

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

Greater clarity on the Accountability of the Council of Lloyds

Proposal **4.9** One respondent suggested that Lloyd's Act 1982 was unclear as to whom the Council of Lloyd's was accountable, and that the 1982 Act be amended to make it clear that the Council of Lloyd's should perform its duties in a manner which (a) properly recognises policyholders' interests and (b) is in the interests of the present members of Lloyd's.

Government's response **4.10** Section 4 of Lloyd's Act 1911 provides, in substitution for section 10 of Lloyd's Act 1871, that the objects of the Society of Lloyd's include "the advancement and protection of the interests of Members of the Society in connection with the business carried on by them as Members of the Society". In addition, the preamble to the 1982 Act sets out the intention for the establishment of the Council:

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

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

Extend the definition of Underwriting Member

Proposal **4.12** One respondent suggested that the definition of "underwriting member" contained in section 2(1) of the Lloyd's Act 1982 be amended to permit the inclusion of structures similar to the Insurance Special Purpose Vehicles (ISPV) recently proposed by the Financial Services Authority, in place of the Annual Venture. He expressed concern that the Reinsurance to Close (RITC) mechanism meant that syndicates were inhibited from adopting a broader or longer-term investment strategy, and were unable to build up reserves beyond their known or anticipated liabilities.

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

4.14 A related proposal was made by another respondent, who suggested that the requirement for all syndicates to perform a reinsurance to close operation (RITC) at the

end of every year imposed an unnecessary burden on those syndicates which are fully aligned Integrated Lloyd's Vehicles (ILV) (whereby both a managing agency and a member of Lloyd's is owned by the same holding company) where the membership of the syndicate does not change from year to year. This respondent proposed that the 1982 Act be amended to remove this requirement for fully aligned ILVs.

Government's response

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

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

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

Proposals from a Lloyd's Name

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

Approval of Lloyd's Byelaws

Proposal

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

Government's response

4.20 As this proposal notes, the Financial Services Authority has responsibility for regulating Lloyd's under FSMA. In particular, under section 314 (1) of FSMA, the FSA has a duty to keep itself informed of the way in which the Council supervises and regulates the market at Lloyd's, and the way in which regulated activities are being carried on in that market. Under rules in the FSA handbook (at INSPRU 8.2.23 – 8.2.29),

the Society must, as soon as it is practical to do so, notify the FSA of its intention to make any amendment that may alter the meaning or effect of any byelaw, and provide the FSA with full details of the amendments concerned. It is also required to consult interested parties in relation to any amendment. The information to be provided to the FSA by the Society must include a statement of the purpose of any proposed amendment and the expected impact, if any, on policyholders, managing agents, members and potential members; and a description of the consultation undertaken, including a summary of any significant responses to that consultation. The guidance given by the FSA states that it expects to receive the information Lloyd's must provide three months before any proposed change.

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

Promulgation of Lloyd's Byelaws

Proposal

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

Government's response

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

4.24 The more relevant provision in the 1911 Act is section 14 of that Act, which requires the Society to publish notices to members, including notices of any byelaws by posting them in the Room at Lloyd's "or in such other manner as may be prescribed by the byelaws of the Society". The Society is not therefore required to publish notice of byelaws only in the Room at Lloyd's. So far as the Lloyd's Acts are concerned, the Society is free to provide for an alternative means of consultation (though, as noted above, it is subject to FSA rules, which require consultation with interested parties). It cannot therefore be said that any burden which may exist on members in consequence of the consultation methods followed by the Society results from the legislation which this proposal would like to amend. There is therefore no power to make the proposed amendment under the 2006 Act.

Compulsory Purchase of Syndicate Capacity

Proposal

4.25 The third proposal was to suggest that a provision analogous to that contained in section 979(2) of the Companies Act 2006 should be included in Lloyd's Act 1982.

Section 979(2) requires an acceptance level of 90% of the shares to which an offer relates before the offeror obtains the right of compulsory purchase from minority shareholders, and it was suggested that the same level of agreement ought to be required before a managing agent could compulsorily acquire syndicate capacity from a member.

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

Government's response

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

Judicial Review of Lloyd's

Proposal

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

Government's response

4.29 The burden which this proposal seeks to remove is not entirely clear. Section 14 of Lloyd's Act 1982 exempts the Society from liability in damages at the suit of a member of the Lloyd's community when it has, in good faith, exercised its discretion in connection with the running of the Lloyd's market. The Court of Appeal has recognised that, were the Society acting unlawfully in its regulatory functions, or in excess of its powers or in bad faith, it could be restrained from doing so[5]. The unavailability of public law remedies given on judicial review applications to members does not result from the statutory immunity in section 14 of the 1982 Act. It is a consequence of a series of court decisions commencing with R v Lloyd's of London ex p Briggs[6] which have found that the relationships between Lloyd's and its members are founded in private law, not public law, and that Lloyd's, in relation to the cases which have so far come before the courts, has not been found to be exercising a public function. It does not therefore appear that this proposal can be said to remove a burden resulting from

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

[6] [1993] 1 Lloyd's Rep 176.

legislation, as required by the 2006 Act. It is therefore not possible for a provision giving effect to this proposal to be included in an Order made under that Act.

Other proposed changes

Number of Members needed to challenge a Byelaw

Proposal **4.30** A further proposal made by the Name above, was that section 6(4) of Lloyd's Act 1982 should be amended so that, instead of requiring a notice in writing signed by 500 members of the Society before the Council is obliged to submit a byelaw or the revocation or amendment of a byelaw to the members of the Society in general meeting, it would only require a notice in writing signed by 50 members of the Society (given that the number of underwriting members has reduced to about a tenth of that in 1982, when the Act was passed).

Government's response **4.31** The Government does not believe it has the power to make this amendment in an order under the 2006 Act. This proposal seeks to make it significantly easier for members who disagree with the provisions of a particular byelaw to require the Council to requisition a general meeting for this purpose. This could impose considerable potential financial costs on the Society of Lloyd's, both in terms of the external costs (which for the 2008 Extraordinary General Meeting were calculated by the Society at approximately £20,000), and in terms of the internal costs in management and staff time which must be dedicated to preparing for and attending the EGM. Even if it could be said that this proposal would remove or reduce a burden on the members of the Society (which is unclear), it would be at the cost of imposing a greater burden on the Society.

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

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

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

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

Amendments to the Voting Weights

Proposal **4.34** A respondent suggested that the weights given to members' votes at general meeting should be changed from "one man one vote" to reflect the contribution made by members of the market. The proposer suggested that this would be more equitable between members, would be closer to a normal company where shareholders' votes

reflect the size of their shareholding, and would help increase the accountability of the Council of Lloyd's to those who fund it.

Government's response **4.35** The only resolutions where all members have one vote on a ballot, regardless of the underwriting capacity they provide, are those proposed at general meetings convened under section 6(4) of Lloyd's Act 1982 on the requisition of 500 or more members of the Society to challenge a byelaw, or the amendment or revocation of a byelaw. All resolutions brought forward at other general meetings are decided, under 14(7) of the Annual and Extraordinary General Meetings Byelaw, by a ballot in which each member has one vote for every £500,000 or part of £500,000 of capacity attributable to that member. There have only been 2 meetings called under this provision since the 1982 Act was passed. In these circumstances, it appears doubtful whether the requirement in section 6(4) of the 1982 Act that resolutions to revoke a byelaw, or amendment of a byelaw, or to annul a revocation of a byelaw must be passed by a majority of the members voting in person or by proxy can be said to impose a burden on members within the meaning of section 1(3) of the 2006 Act.

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

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

Scope of Lloyd's Statutory Immunity

Proposal **4.38** The Names Action for Compensation and Defence in Europe (NACDE) and an underwriting member of Lloyd's argued that section 14 should be repealed. That section exempts the Society from liability in damages at the suit of a member of the Lloyd's community (which includes Lloyd's members, Lloyd's brokers and underwriting agents) when it has, in good faith, exercised its discretion in connection with the running of the Lloyd's market. NACDE argued that this immunity is a contradiction to principles of corporate responsibility, which has created a culture at Lloyd's that believes itself to be outside the scope of ordinary law, giving members of the Council of Lloyd's greater protection than members of the Financial Services Authority.

Government's response **4.39** It is not clear that the repeal of section 14 can be said to remove or reduce a burden. In addition, the Government is concerned that repealing section 14 would remove a necessary protection for the Society. The immunity granted to Lloyd's prevents the Society from being sued for damages in relation to the exercise or failure to exercise the powers, duties and functions granted to it by the Lloyd's Acts or regulations or byelaws made under those Acts. It fulfils an equivalent protective function to immunities granted to other bodies such as the Financial Services Authority (which has been granted exemption from damages under section 102 of the Financial Services and Markets Act 2000), and recognised investment exchanges and clearing houses (granted a similar exemption under section 291 of that Act). In the case of the Society, and recognised exchanges, Parliament has recognised that a limited immunity from suit serves the interests of ensuring that the markets in question are run effectively and

efficiently, and that the bodies concerned are not deterred from properly policing those markets. Accordingly, a provision repealing section 14 would not satisfy the precondition in section 3(2)(d) of the 2006 Act, and cannot therefore be included in an order made under that Act.

Proposal

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

Government's response

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

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

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

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

have given rise to liability at the time when they took place. This appears to be the case here.

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

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

5 NEXT STEPS

5.1 The draft LRO has now been laid before Parliament. Respondents are welcome to put their views before either or both of the Scrutiny Committees, either on the substance of the LRO or the proposed Parliamentary procedure.

5.2 In the first instance, this should be in writing, and the Committees normally decide on the basis of written submissions whether to take oral evidence.

5.3 The Scrutiny Committees appointed to scrutinise Legislative Reform Orders can be contacted at

House of Lords

Delegated Powers and Regulatory Reform Committee

House of Lords

London

SW1A 0PW

Tel: 0207 – 219 – 3103

Fax: 0207 – 219 – 2571

E-Mail: dprr@parliament.uk

House of Commons

Regulatory Reform Committee

House of Commons

7 Millbank

London

SW1P 3JA

Tel: 0207 – 219 – 2830/2833/2837

Fax: 0207 – 219 – 2509

E-Mail: regrefcom@parliament.uk

A LIST OF CONSULTATION RESPONDENTS

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

Society of Lloyd's

Lloyd's individual members

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

Association of Lloyd's Members

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

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

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

Industry/Trade Associations

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

Individuals

Sir Peter Miller
Richard Southwell QC
Michael Wade
Sir David Walker

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