EXPLANATORY MEMORANDUM TO THE

THE INSURANCE ACCOUNTS DIRECTIVE (LLOYD'S SYNDICATE AND AGGREGATE ACCOUNTS) REGULATIONS 2004

2004 No. 3219

1. This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Description

2.1 The regulations implement the Modernisation of Accounts Directive 2003/51/EC for the Lloyd's of London insurance market. The Directive changes Lloyd's accounting to an annual basis as opposed to an underwriting year basis and aligns the accounting requirements for Lloyd's syndicates to the requirements for other types of insurance undertaking.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Background

4.1 These Regulations implement the Directive amending existing accounting directives on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings [1] ("the Modernisation Directive") for Lloyd's.

4.2 The Modernisation Directive aims to enable undertakings to follow modern, more transparent accounting practices that are more consistent with International Accounting Standards. It will apply to those undertakings which are not required to use International Accounting Standards including Lloyd's and Lloyd's syndicates.

4.3 The Modernisation Directive achieves this objective by amending the four EU Directives that form the basis of European accounting requirements:

- 1978 Fourth Directive on Company Accounts
- 1983 Seventh Directive on Consolidated Accounts
- 1986 Directive on Accounts for Banks and other Financial Institutions
- 1991 Insurance Accounts Directive

[1] Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635 and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings, OJ L 178/16 of 17 July 2003.

4.4 The amendments to Directive 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings[2] repeal an Annex which prescribed specific accounting arrangements for Lloyd's syndicate and aggregate accounts. Lloyd's syndicates and Lloyd's are now deemed to be insurance undertakings for the purposes of the Insurance Accounts Directive and syndicates are required to prepare annual accounts on the same basis as insurance companies and other types of insurance undertaking. Lloyd's is still required to produce aggregate accounts rather than being required to produce consolidated accounts.

4.5 These Regulations apply provisions of the Companies Act 1985 relating to the preparation and format of accounts for insurance companies, with the necessary modifications, to Lloyd's. The Regulations are made under section 2(2) of the European Communities Act 1972. A Transposition Note is attached as Annex A.

4.6 Scrutiny of the Modernisation Directive:

- DTI Explanatory Memorandum 9730/1/02 REV1 COM (2002) 25912 final was submitted on 26.02.02. Commons European Scrutiny Committee considered it politically important and cleared it (Report No 37, Item 23522, Session 01/02). Lords Select Committee on the EU cleared it on 09.07.02 (Progress of Scrutiny 22.07.02, Session 01/02).
- DTI Explanatory Memorandum OTNYREM was submitted on 05.12.02. Commons European Scrutiny Committee considered it politically important and cleared it (Report No. 5, Item 24060, Session 02/03). Lords Select Committee on the EU did not report on it (Progress of Scrutiny 21.12.02, Session 02/03).

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

Not applicable

7. Policy background

7.1 The overall policy objective of the Modernisation Directive is to remove conflicts between the Accounting Directives and IAS in existence at the time it was drawn up and ensure that optional accounting treatments currently available under IAS in existence at 1 May 2002 are available to EU undertakings which continue to have the Accounting Directives as the basis of their accounts (i.e. those undertakings which will not prepare their accounts in accordance with the EU Regulation on IAS). In general, the Modernisation Directive amendments are technical amendments to existing accounting requirements. Specifically in relation to Lloyd's the Modernisation Directive

[2] OJ L 374 of 31 December 1991.

aims to change the basis of accounting so that the market reports in line with other insurance undertakings.

7.2 Lloyd's requested the change be inserted in the Directive so as to statutorily amend their basis of accounting from 3 year to annual. These regulations are solely relevant to the Lloyd's insurance market. The Government's approach has been to ensure that the UK's European obligations are met whilst ensuring there is no reduction in disclosure and transparency.

7.3 A 3 month public consultation was conducted on the proposals during which we received 19 responses. All respondents conduct business with or in the market.

7.4 Interest in these changes is largely confined to the Lloyd's market. These regulations implement a request by Lloyd's for a change to their statutory accounting status.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 There is no impact on the public sector as this Statutory Instrument only applies to Lloyd's and Lloyd's syndicates.

9. Contact

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Regulatory Impact Assessment

1. Title

IMPLEMENTATION OF THE EU DIRECTIVE 2003/51/EC FOR LLOYD'S (AMENDING DIRECTIVE 1991/674/EEC INSURANCE UNDERTAKING – ANNUAL AND CONSOLIDATED ACCOUNTS).

2. Purpose and intended effect of measure

Objective

2.1 To implement the Modernisation of Accounts Directive enabling the accounts of syndicates undertaking business at Lloyd's to be compiled to those of other insurance undertakings whilst ensuring there is no reduction in levels of disclosure or transparency.

Background

2.2 The Insurance Undertaking – Annual and Consolidated Accounts Directive (the IAD) is concerned with the presentation and content of insurance firms annual accounts and annual reports (including consolidated accounts).[3] The Directive creates a unified accounting approach across Europe for insurance undertakings within its scope to enhance comparability. Originally the IAD applied to Lloyd's through an annex outlining alternative specific provisions for Lloyd's accounting. These provisions prescribe that syndicate accounts are to be prepared in line with its underwriting on a 3 year fund accounting basis.

2.3 The IAD has now been amended by the Modernisation of Accounts Directive (Modernisation Directive).[4] The effect of this measure is that, in line with Lloyd's wishes, the Annex to the IAD, which detailed the arrangements for 3 year fund accounting for Lloyd's syndicate and an aggregation of syndicate accounts (Globals), has now been repealed. Now the main body of the Directive is applicable to syndicate accounts. The Modernisation Directive, having deleted the Annex to the accounts with the specific disclosures of information for Global accounts, now simply prescribes aggregate accounts, thus not changing the accounting basis for the Globals.

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

2.5 The amendment was included in the Modernisation Directive at the request of Lloyd's. By making the body of the Directive applicable to Lloyd's, syndicates will be required to produce annual accounts. This should provide Lloyd's with a level of comparability with other insurance undertakings who report on this basis. The change could also benefit auditors and investors, to whom, the 3 year fund

[3] Insurance Accounts Directive (1991/674/EEC)
[4] Modernisation of Accounts Directive (2003/51/EC)

accounting system may have been unfamiliar. The move to annual accounting is part of Lloyd's programme of modernising the market.

2.6 Lloyd's operates as an insurance market place where individuals and bodies corporate underwrite insurance business at Lloyd's as a member of one or more syndicates. Syndicates generally have a number of members although there is an increasing number of single corporate member syndicates. Managing Agents manage the syndicates and are responsible for determining underwriting policy, accepting the risk, closing the account through reinsurance and settling the claims. In this respect they adopt the equivalent role of Director in a company structure.

2.7 Each Lloyd's syndicate is an annual venture after which membership of a syndicate can change, although not for one member syndicates. The syndicate account does generally not close its accounts until the end of 3 years which is when any profit or losses are distributed. The accounts, as presently reported showing the open balances of syndicates at the 12 and 24 month stages and then the closed year at the end of 36 months, with the final profit or loss distributed. This layout shows important information for members as it clearly distinguishes each annual venture and indicates how it is performing at each stage of the venture

2.8 Annual accounts would be prepared using the information from the 3 annual ventures to present an account of the syndicate during the year it is reporting.

2.9 A formal and informal consultation exercise has been conducted including a 3 month consultation period.

Risk Assessment

2.10 Currently, accounts at Lloyd's are reported and prepared in a manner very different from other insurance undertakings. Not implementing the Modernisation Directive would mean this would continue, hindering comparability. Investors and market participants are restricted when comparing information from the accounts of those undertakings participating in the Lloyd's market and other insurance undertakings. Lloyd's requested the amendment to its statutory accounting basis as part of a modernisation drive of which annual accounting is seen as a key driver. It is hoped that increased comparability in the accounts would be attractive to new investors and assist current market participants. Lloyd's currently require syndicates to compile pro forma annual accounts in a similar format to that prescribed by the IAD. However, these accounts do not have a statutory basis for preparation or an auditor's opinion. We would presume this would continue should the Modernisation Directive not be implemented.

3. Policy Options

3.1 The Modernisation Directive does not change the basis of accounting for the aggregate accounts (Globals) and the regulations reflect this. The policy options set out below are solely to do with syndicate accounts due to the changing basis of preparation.

3.2 The IAD was previously implemented for insurance companies through Schedule 9A of the Companies Act 1985. Schedule 9A prescribes additional requirements for insurance companies than purely transposing the IAD. For non-company insurance undertakings (Lloyd's and Lloyd's syndicates are not companies) the IAD was implemented through the Miscellaneous Insurance Undertakings Regulations 1993 which made certain sections of Schedule 9A applicable.[5]

3.3 Regardless of our chosen method of implementation, Lloyd's will still require 3 year fund information to be produced (at least for members and internal purposes) in order to determine distribution and the closed year result. If not provided for in the regulations Lloyd's have indicated they would require the preparation of distribution accounts. During the last few years Managing Agents have been required, by Lloyd's, to produce both 3 year fund accounts, as currently published and annual accounts. Again, regardless of our implementation, we believe this requirement would continue.

3.2 We believe there are three main implementation options available:

Option 1: Do nothing. This would result in the continuation of underwriting 3 year fund accounts being produced. In addition, we would presume that Lloyd's would continue to require syndicates to produce pro forma annual accounts, but these reports would have no statutory basis for either their preparation or the auditors opinion.

Option 2: Do the minimum necessary to meet the requirements of the Directive by making applicable only those parts of Schedule 9A which are relevant to Lloyd's and only transpose the IAD. This option does not include applying sections of the Companies Act which are relevant to the other Insurance companies but not part of the IAD.

Option 3: Implement the Directive consistently with the accounting requirements for other UK insurers, as far as possible. This would involve applying the relevant sections of the Companies Act 1985 Schedule 9A.

This option can be further analysed between 4 sub-options with differing levels of additional disclosure:

a) Implement the Modernisation Directive by applying the relevant sections of the Companies Act 1985 Schedule 9A that transpose the Directive and apply additional provisions which prescribe further requirements and disclosures, with the relevant amendments. This option will go beyond the minimum required by the IAD by applying additional provisions of Schedule 9A to bring the accounts in line with other insurance companies. This would help make Lloyd's accounts more comparable with other insurance undertakings.

b) Implement the Modernisation Directive by applying the relevant sections of the Companies Act 1985 Schedule 9A that transpose the IAD and apply additional provisions which prescribe further requirements and disclosures, with the relevant amendments. In particular, to include the requirement for Managing Agents to include in the notes to the accounts a breakdown of the figures by underwriting year of account to include the annual venture figures. This would include details of the result of the closing year of account (after 3years) and balances on the open years of account.

c) Implement the Directive by applying the relevant sections of the Companies Act 1985 Schedule 9A that transpose the Directive and apply additional provisions which prescribe further requirements and disclosures, with the relevant amendments. In particular, to include the requirement for Managing Agents to a prepare report

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

giving a True and Fair view of the underwriting account in respect of the closing year as a supplementary document to the accounts without duplicate disclosure of information. This supplementary document would be prepared on a different accounting basis with a different auditor's opinion.

d) Implement the Directive by applying the relevant sections of the Companies Act 1985 Schedule 9A that transpose the Directive and apply additional provisions which prescribe further requirements and disclosures, with the relevant amendments. In particular, in the annual accounts include the requirement for Managing agents to prepare full 3 year fund accounts, (like those prepared now) as a supplementary document to the annual accounts.

4. Costs

Option 1: Do Nothing

A direct and immediate cost of doing nothing will be infraction fines levied by the European Court of Justice for each day that the Directive is not implemented for Lloyd's. Not implementing the Directive would be a breach in our European Treaty obligations. We would expect Managing Agents to continue to produce annual accounts (similar to Schedule 9A accounts) in addition to the 3 year fund accounts. However, there would be no regulations prescribing how this should be done which could lead to a lack of comparability amongst syndicates and insurance companies.

Option 2: Minimum Necessary to Implement the Directive

There should be no or very little increased costs in the form of human resource hours to adopting this option. Going forward, as now, Managing Agents will need to prepare the accounts with the help of accountants and an auditor's opinion will be required. Those currently involved with the accounts will need to familiarise themselves with the new requirements.

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

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

Managing Agents would still have to produce separate distribution accounts and Lloyd's would have to prescribe how this should be done in their byelaws.

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

This option would also mean significantly less information disclosed in the accounts and the separate production of distribution accounts, prescribed by Lloyd's.

Option 3:

Annual accounts

a) Overall the costs should be similar to those of option 2. However, the costs may be less as those involved with the accounts (particularly accountants and actuaries) will be applying a regime to Lloyd's with which they are more familiar through applying it to insurance companies. This option would also mean significantly less information disclosed in the accounts than currently. However, as in option 2, Managing Agents would still have to produce separate distribution accounts.

Annual Accounts with underwriting information in notes

b) This option would require some incremental costs from Option 3 a) as it would require extra work to be done and signed off by auditors. However, Managing Agents and their auditors, whether repeated or not, will nevertheless carry out practically all this work regardless in order to determine results. There would be additional costs in the difficulties surrounding compiling this information into a note of the same report as the information contained in the annual account prepared under an annual accounting basis and signed off as True and Fair. In adition, auditors are unsure whether they would be able to sign off on such a requirement and as in option 3 a), Managing Agents would still have to produce separate distribution accounts.

Annual Accounts with separate True and Fair closed underwriting account

c) The costs would be very similar to option 3 b). As a supplementary document, the information would be prepared under a different accounting basis and signed off under a different opinion. It is easier for auditors to produce the information on this basis in this format and it would not include any duplication of information disclosed. As in 3 b), practically all this work will be carried out anyway by Managing Agents and their auditors to some extent in order to determine results. The additional costs, compared to option 2 and 3 a), are that this information would need top be compiled into a report and signed off by auditors. However, this option would cost less than 3 b) as it is more straightforward for auditors to produce and provide more information.

Annual Accounts and full 3 year fund accounts

d) This option would result in similar costs to option 3 b). However, there would be the full disclosure requirements in the supplementary documents detailing full 3 year fund accounts as they currently stand. Although much of this work would again be carried out anyway, it would mean Managing Agents were obliged to report two full sets of accounts prepared under different accounting basis with different opinions and could produce increased costs compared to the other options. In addition there would be some duplication of information reported.

5. Benefits

Option 1: Do Nothing

Lloyd's accounts will continue to be prepared on a different basis to the rest of the insurance industry. Lloyd's wants its accounts to be more comparable with other insurers and could continue to require additional accounts to be prepared on a more comparable annual basis. Most syndicates would still prepare annual accounts but there would be the possibility that they would not be comparable. There are therefore few, if any, benefits to not implementing the Directive.

Option 2: Minimum Necessary to Implement the Directive

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

Option 3:

Annual Accounts with underwriting information in notes

a) The production of annual accounts as applied through the application of Schedule 9A beyond the IAD would provide the same benefits as Option 2. In addition application of provisions beyond the IAD would make the accounts more comparable with other insurance undertakings. Investors and auditors would also be more familiar with the fuller provisions reported in a similar report. Any further amendments to insurance accounting legislation would also be automatically applied to Lloyd's without the necessity for separate provisions.

Annual Accounts with underwriting information in notes

b) Annual accounts as produced under Option 3 a) would still mean significantly less information reported and disclosed than is currently the case. Including the requirement for Managing Agents to include in the notes to these accounts a breakdown of the figures by underwriting year of account would increase transparency. This would include details of the result of the closing year of account (after 3 years) and balances on the open years of account. It would be an indication to members of how their annual venture syndicate fund year was performing (with the relevant uncertainty disclosed in the notes). All this information would be included in the one document and report. The additional disclosures necessary to include this information would negate from the transparency and cause many of the numbers meaningless.

Annual Accounts with separate True and Fair closed underwriting account

c) Under this option there would be an additional supplementary report which would provide the information which would be in a note to the accounts in option 3 b). This is important information for all market practitioners, especially members, and would provide greater transparency for investors and for capital raising purposes. The information, for the closed year, in the supplementary document would be signed off by auditors as True and Fair and give a more transparent reflection of the syndicates as annual ventures. Managing Agents will be able to use the annual accounts as a source of comparability with insurance companies whilst the production of a report of the underwriting closed year of account shall provide figures which distinguish Lloyd's syndicates as annual ventures.

This option, including the audited supplementary underwriting accounts, is also consistent with the FSA's rules to permit interim profit distribution. This option would avoid Lloyd's having to prescribe additional distribution accounts. It is also less complicated and demanding on auditors to report the information in this way.

As part of this policy the regulations contain an option where, if the members of a syndicate for each underwriting year agree unanimously, they do not have to produce underwriting year accounts. This enables single member syndicates (or syndicates with aligned corporate members) to simply produce annual accounts as there are fewer disclosure reasons for them to report the underwriting information.

Annual Accounts and full 3 year fund accounts

d) All the benefits of The production of standard 3 year fund accounts, as currently produced, alongside the Schedule 9A annual accounts would mean members would receive the full set of information and disclosures as they currently receive in addition to the new annually prepared accounts under Schedule 9A.

6. Competition Assessment

6.1 We have fully considered the competition filter test. The IAD requirements will apply equally to all market participants, whether new entrants or established firms. It is not expected that the IAD will give rise to higher costs for new firms as opposed to established firms, nor should it affect the structure of the market and the proposed changes should help Lloyd's accounts to be considered on a comparable basis with those undertakings reporting in the rest of the insurance sector.

7. Business Sectors affected

7.1 We have been unable to identify any negative impacts on small firms as a result of the proposals and therefore do not intend to carry out stage one of the small firms impact test. We have agreed this approach with the SBS.

8. Enforcement and Sanctions

8.1 We believe there are approximately 66 syndicate accounts. The Financial Services Authority (FSA) will accept, file accounts, scrutinise accounts and enforce sanctions. This is an area of increased costs for the FSA, as the Society of Lloyd's currently fulfils this role. The FSA have been fully consulted on this issue and are aware of the obligations in the proposals.

9. Summary and Recommendation

9.1 Option 3 b) is the preferable approach. It provides a good level of transparency and disclosure in the accounts for members. In addition, annual schedule 9A accounts will be produced reporting information which is compatible and comparable between the Lloyd's and insurance companies. Comparability will help investors in their selection upon where to invest and assist market participants in reporting on a familiar manner to the rest of the insurance sector. Option 3 b) includes annual accounts on a comparable basis as well as including vital information which distinguishes the unique structure of Lloyd's and provides transparency for market participants.

IMPLEMENTING THE MODERNISATION OF ACCOUNTS DIRECTIVE 2003/51/EC [6] IN RELATION TO LLOYD'S OF LONDON– A TRANSPOSITION NOTE

THE INSURANCE ACCOUNTS DIRECTIVE (LLOYD'S SYNDICATE AND AGGREGATE ACCOUNTS) REGULATIONS 2004

Introduction

1. The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 implement the Modernisation of Accounts Directive in relation to Lloyd's of London.

2. European Union (EU) accounting requirements are based primarily on four Accounting Directives; the Fourth[7] and Seventh[8] Directives on the annual and consolidated accounts of companies: the Directive on the annual and consolidated accounts of banks and other financial institutions[9] ("the Bank Accounts Directive"); and the Directive on the annual and consolidated accounts of insurance undertakings[10] ("the Insurance Accounts Directive").

3. The Modernisation of Accounts Directive amends the Accounting Directives to bring them more into line with International Accounting Standards. In relation to Lloyd's it makes specific and extensive amendments of the Insurance Accounts Directive requirements for the accounts of Lloyd's syndicates and the accounts of Lloyd's as a whole. For Lloyd's syndicates it removes the annex to the Directive which previously permitted them to prepare their accounts on a different basis. Syndicates are now required to produce their accounts on the same basis as other insurance undertakings under the Insurance Accounts Directive. There is still a derogation in respect of the overall Lloyd's accounts in that they are to be prepared as aggregated accounts rather than as consolidated accounts.

5. Articles 1 to 3 of the Modernisation of Accounts Directive do not apply to Lloyd's as they are amending other Accounting Directives. Article 4 does apply to Lloyd's as it is this article which amends the Insurance Accounts Directive.

Article	Objectives	Implementation	Responsibility
4	Applies the Insurance Accounts Directive to the association of underwriters known as Lloyd's. It requires Lloyd's syndicates to produce annual accounts in accordance with the provisions of the Insurance Accounts Directive. It requires Lloyd's to produce annual aggregate accounts.	The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 implement these requirements. In relation to syndicate accounts regulation 3 does this by requiring managing agents of syndicates to produce accounts which comply with	HM- Treasury

[6] Directive 2003/51/EC of the European Parliament and Council amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (OJ L178 of 17.7.2003).
[7] Fourth Council Directive of 25 July 1978 (78/660/EEC) on the annual accounts of certain types of companies (OJ L222/11 of 14.8.1978).
[8] Seventh Council Directive of 13 June 1983 (83/349/EEC) on consolidated accounts (OJ L193/1 of 18.7.1983).
[9] Council Directive of 8 December 1986 (86/635/EEC) on the annual accounts and consolidated accounts of banks and other financial institutions. OJ L372/1 of 31 December 1986.
[10] Council Directive of 19 December 1991 (91/674/EEC) on the annual accounts and consolidated accounts of insurance undertakings. OJ L374/7 of 31 December 1991.

		the relevant requirements of the Companies Act 1985 as adapted by these Regulations for syndicates. These include provisions on auditing the accounts and the production of a directors' report. Further provisions in Part 2 of these Regulations implement the obligations to publish the accounts and impose penalties if the requirements of the regulations in relation to syndicate accounts are not complied with. Regulation 8 requires the Council of Lloyd's to prepare aggregate accounts by cumulating the syndicate accounts prepared for a financial year. Part 3 of the Regulations also requires the Council to prepare an annual report and to obtain an auditors' report on the aggregated accounts.	