

September 2008

Our reference MSNL/15

## **MARKET SERVICES' NEWSLETTER**

Welcome to the latest edition of the Members' Update keeping you updated on events within Market Services.

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### **1 Release of Funds at Lloyd's and Outstanding Overseas Tax Liabilities**

#### **Release of Funds at Lloyd's on cessation**

Tax is increasingly becoming a matter for consideration when members request a release of their Funds at Lloyd's (FAL). When all of a member's underwriting years have closed, FAL are only eligible for release once all outstanding liabilities including some overseas taxes have been met. This was communicated in Market Bulletin Y2577, dated July 2001, but we felt it would be worthwhile reminding members of the process and factors taken into account

when receiving requests to release FAL. The guidelines previously circulated to Corporate members, accountants and members' agents appear below, however they should be treated as an overview as the position may vary according to the class of membership. Although Lloyd's is committed to releasing a members' funds as soon as possible after all outstanding years of account have been closed, we must ensure that in achieving this objective the Central Fund is not exposed to any risk.

## **Background**

In accordance with central arrangements and agreements, Lloyd's settles a number of overseas taxes on members' behalf. Generally, these taxes are collected from the syndicates and recovered from members through the distribution mechanism. When a member's final underwriting account closes, that member will still need to be included on a minimum of two further US tax returns and one final Canadian tax return, which may give rise to further tax liabilities. For example, since US tax is calculated on a calendar year basis, a member whose final underwriting year closed at 31 December 2007 needs to include their 2007 calendar year tax result in the 2007 tax return (which will not be completed until December 2008.) Further tax liabilities, relating to prior year tax returns, could also arise if the IRS<sup>1</sup> or Canadian Tax Authorities seek adjustments to tax upon audit.

Whilst it has always been necessary for Lloyd's to consider the retention of funds to cover potential overseas tax liabilities, it has become increasingly difficult to assess the unpaid outstanding liabilities since carried forward overseas tax losses are being used up; member's tax affairs are becoming more complex and members are requesting their FAL be released much earlier.

## **Procedures when considering a release of FAL**

When a member or their advisor makes a request for FAL to be released and it is confirmed that all other liabilities have been met, the application is checked to determine whether there are any potential outstanding overseas tax liabilities.

In making such an assessment we consider whether sufficient information is available to make an estimate of the member's future tax liabilities and whether there is any risk of future audit adjustments. Broadly, if a member's tax affairs are straightforward, we may be able to estimate an appropriate retention (if sufficient information is available). However, where the tax affairs are more complex and in order to protect the Central Fund we may also require an indemnity.

## **Members with straightforward overseas tax affairs**

If the circumstances are straightforward, we will consider making an estimate of an appropriate retention once all of the applicable US Syndicate Information Statements

<sup>1</sup> Internal Revenue Service – US Government Agency responsible for collection of tax

("SISs") have been submitted and reviewed by our US lawyers, Dewey and LeBoeuf. Provided the syndicate meets the US timetable for the preparation of the US tax return and there are no items of dispute, we would expect to make an estimate by October in the year following cessation at the latest and we will seek, where possible, to be in a position to make an earlier decision.

However, if a member's parent company, capital provider or other suitable party is prepared to provide an indemnity for the full amount of FAL and Lloyd's agrees to accept such an indemnity from the party concerned, we may be in a position to agree to a partial release of the FAL. The indemnity can then be released once the overseas tax liability has been determined provided that the retained amount is sufficient to cover it.

### **Other Members (including third party FAL providers)**

Many members' overseas tax affairs are more complex. This generally means that the calculation of the member's overseas tax liability is more complicated and as a result cannot be estimated with as much certainty. This is particularly the case where a position taken by the member may be subject to interpretation by an overseas tax authority which could lead to adjustment on audit.

In such cases, we will if possible make an estimate of an appropriate retention (once the relevant SISs are available) but we are also likely to require an indemnity from a suitable counterparty up to the amount of FAL being released. This indemnity will remain in place until all audits covering relevant periods have been closed and will cover all tax liabilities as well as any associated legal costs incurred in defending any challenge from the overseas tax authority. Such legal fees will only be incurred with the member's agreement.

Lloyd's will make every effort to release FAL as soon as possible whilst ensuring that there is no risk to Central Fund due to unpaid tax liabilities. We trust that members, capital providers and their advisors will take this into consideration when making requests for the release of FAL.

For further information on releases please contact : Gavin Bennett 01634 392444

E-mail [gavin.bennett@lloyds.com](mailto:gavin.bennett@lloyds.com)

For further information on the impact of any tax liabilities on a release please contact :

Phil Waghorne 01634 392472

E-mail [philip.waghorne@lloyds.com](mailto:philip.waghorne@lloyds.com)

## **2 Cessation of Individual Membership of Lloyd's**

Periodically, Market Services reviews the underwriting position of resigned members.

Once all of the syndicates on which a member has participated have closed by reinsurance and all outstanding liabilities have been settled and all Funds at Lloyd's (FAL) released, individual members are eligible for the cessation of their membership.

Members who have converted to limited liability and who have interavailable (IA) funds in place will not be ceased from their individual membership whilst the IA funds remain in place. However, where a member has converted to limited liability and has no IA funds, the membership of the individual will cease and the underwriting of the corporate member will continue unaffected.

Members who have purchased an Exeat policy may also be eligible for cessation provided that all outstanding liabilities not covered by the Exeat policy have been settled, all FAL have been released and the members do not have an I/A arrangement as detailed above.

Members who have not written insurance business for at least 3 consecutive years, but who have not formally resigned their membership of Lloyd's and who have no outstanding liabilities will also be eligible to have their membership ceased. In these instances, we will write to the member advising that we are considering ceasing their membership and asking them to make written representations by a given date should they not wish their membership to be ceased at that time.

We will shortly begin considering members for cessation as at 31 December 2008 and members who are eligible will receive a letter at the beginning of January 2009 giving them formal notice of their cessation.

For further information on cessations please contact : Jenny Hill 01634 392887

E-mail [jenny.hill@lloyds.com](mailto:jenny.hill@lloyds.com)

## **3 Members' Cash Investment Strategy**

Members' assets not otherwise invested at the direction of the member are pooled and invested by Lloyd's, as trustee. Money-market investments are utilised with the objective of maximising current income, whilst seeking preservation of capital. All income earned, less annual distribution fees, is distributed to members pro rata to the value of their participation. Traditionally, the wholesale money-market is used to place deposits of varying maturity with selected bank counterparties. Such deposits are diversified between a number of banks, to control credit risk, and all counterparties must be constituents of an approved bank lending list, maintained for this purpose and reviewed quarterly by the Lloyd's Investment Committee. This approach has achieved competitive returns on members' cash investments over an extended period.

From the middle of 2007, adverse developments relating to sub-prime mortgage debt and, subsequently, the wider 'credit crunch', have significantly increased the credit risks arising from exposure to banks and other financial institutions. At the same time, growing illiquidity in the wholesale money-market has made it increasingly difficult to effectively utilise this mechanism for lending purposes. As a result of these developments, approximately 50% of members' cash assets are currently being invested in Government issued debt securities. As well as reducing overall exposure to bank credit, this has allowed a reduction in the maximum exposure to individual banks and greater flexibility in selecting bank counterparties. This change in investment strategy is believed to be prudent in the current environment in view of the need to protect the capital value of members' assets and has been ratified by the Lloyd's Investment Committee.

As a consequence of this decision to utilise Government debt within members' cash investments, the investment return achieved for the benefit of members has fallen, reflecting the lower level of yields available. It is estimated that the return currently being achieved on these assets is as much as 0.75% (per annum) below that which would have previously have been possible. This situation is reviewed on an ongoing basis and we continue to seek to optimise returns whilst operating within acceptable levels of risk.

Mutual funds, operating under the European UCITS (Undertaking for Collective Investment in Transferable Securities) regulations, investing in money-market securities and rated 'AAA' by one or more of the major credit rating agencies, represent a potentially useful additional investment type for use within the members' cash pool. Historically, issues surrounding the tax treatment of such investments have prevented their use. However, work carried out recently by the Lloyd's Taxation Department has allowed us to resolve these issues and it is intended to commence selective investment in such UCITS vehicles shortly. Although these vehicles will not provide a complete solution to the difficult market conditions currently affecting members' cash investment returns, it is anticipated that they will help to improve returns in the coming months.

#### 4 Members' Cash Interest Rates

Members are advised of the interest rates applied to cash held within Funds at Lloyd's covering the period 27 June 2008 to 5 September 2008. Please note the rates quoted below are net of the Market Services cash handling charge of 0.125%.

<u>Currency</u>	<u>Period</u>	<u>Rate</u>
GBP	27/06/2008 – 05/09/2008	4.5%
US Dollar	27/06/2008 – 27/07/2008	1.25%
	22/07/2008 – 05/09/2008	1.875%

Euro	27/06/2008 – 13/08/2008	3.875%
	14/08/2008 – 05/09/2008	4.25%
Aus Dollar	27/06/08 – 13/08/2008	5.125%
	14/08/08 – 05/09/2008	5.75%

The next interest payment will be applied as at 31 December 2008 and will be paid into members' bank accounts in early January 2009. Members are requested to keep Market Services up to date with any changes to their bank account details. Please note, notification of a change of bank account details must include copy evidence that the bank account and beneficiary account name correspond to that of the member e.g. provision of a copy paying-in slip. Changes should be notified in writing to the Membership Arrangements Team at the address on the bottom of page 1 of this newsletter.

For further information please contact : Janice Baldwin 01634 392294  
E-mail [janice.baldwin@lloyds.com](mailto:janice.baldwin@lloyds.com)

## 5 Italian Capital Gains Tax

Market Services hold all International Securities with a sub-custodian, Citibank. Citibank have notified us that with effect from the beginning of October 2009, non-Italian residents can obtain an exemption from the capital gains tax on non qualified holdings of Italian Listed equities, bonds, convertible bonds, rights and warrants providing a relevant declaration form is completed by Lloyd's.

As custodian of the assets, Lloyd's will automatically lodge the appropriate form with Citibank for those accounts where the member does not reside in Italy.

In order to ensure that the correct tax is applied to your assets and our records are kept up to date, please ensure that if your address changes, you inform us as soon as possible using the same contact information as detailed in section 4, Members' Cash Interest Rates.

For further information please contact : Anne Cooper 01634 392576  
E-mail [anne.cooper@lloyds.com](mailto:anne.cooper@lloyds.com)

I hope you have found this newsletter informative and if you have any comments or proposals for articles to be included in future newsletters please let me know.

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