Consultation on Lloyd's accounting regulations:

Impact Assessment

October 2008

HM TREASURY

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ISBN 978-1-84532-510-7
PU673

SUMMARY: INTERVENTION & OPTIONS

HM TreasuryDepartment	**ImpactImpact Assessment of regulations to implementAssessmentof Directives 2006/43/EC and 2006/46/EC, and make other reporting amendments, with respect to Lloyd's**

StageVersion Implementation	**2**	

Available to view or download at: www.hm-treasury.gov.uk
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What is the problem under consideration? Why is government intervention necessary?
To give effect in UK law and implement Directives 2006/43/EC and 2006/46/EC in relation to Lloyd's syndicate and aggregate accounts, and to make consequential amendments necessary subsequent to the enactment of the Companies Act 2006. This will help to ensure minimum levels of investor protection, and reduce the risk of future financial scandals and any adverse impact on investor confidence.

What are the policy objectives and the intended effects?
The main objective of the legislation is to ensure that the Lloyd's Syndicate and Aggregate Accounts Regulations comply with the EU directives and so to increase the transparency of the accounts. This will enhance confidence in the financial statements and annual accounts published by Lloyd's syndicates (and the Lloyd's aggregate accounts), allowing members and stakeholders to make comparable assessments of different syndicates by having access to complete and reliable information in relation to their financial arrangements.

What policy options have been considered? Please justify any preferred option.
1. Do nothing. 2. Give effect in UK law and implement Directives 2006/43/EC and 2006/46/EC in relation to Lloyd's Syndicate and Aggregate Accounts and make consequential amendments necessary subsequent to the enactment of the Companies Act 2006. Policy option 2 is preferable as it will help to enhance confidence in Lloyd's financial statements and annual accounts. Also, if option 2 is not taken, the UK would be open to infraction proceedings from the European Commission.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 03/2011

Ministerial Sign-off

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister:

Kitty Ussher

Date: 17/7/08

SUMMARY: ANALYSIS & EVIDENCE

Policy Option	*Description*

ANNUAL COSTS

One off (Transition) | £- | Yrs | -

Average Annual Cost (excluding one-off)

£ 0.015 m – 0.03m

Description and scale of **key monetised costs** by 'main affected groups'
Additional Audit costs incurred due to extra disclosure requirements, related party and off balance sheet transactions, and recording and verifying non-audit work performed by accountants.

£ 0.024

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

ANNUAL BENEFITS

One off | £ - | Yrs |

Average Annual Benefit (excluding one-off)

£ 1.1 m

Description and scale of **key monetised benefits** by 'main affected groups'
Benefits arising from increased transparency for Lloyds members increasing confidence and market efficiency.

Total Benefit (PV)

£ £ 10.25 m

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

Increased investor confidence may attract additional investment.

Key Assumption/Sensitivities/Risks Key assumptions: Discount Rate of 3.5% , Cost incurred on an annual basis, Cost calculated on the basis of accounts fees of £30-£50 an hour. Discount period is assumed to be 10 years (in line with IA guidance).

Price Base Year 2007	Time Period Years 10	**Net Benefit Range** (NPV) **£ 10.23 m – 10.226 m**	**NET BENEFIT** (NPV Best estimate) **£ 10.23 m**

What is the geographic coverage of the policy/option?	UK wide
On what date will the policy be implemented?	December 2008
Which organisation(s) will enforce the policy?	FSA
What is the total annual cost of enforcement for these organisations?	0
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£ 10,450

What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Med	Large
Are any of these organisations exempt?	No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)

Increase of £ 224,812 Decrease of £ 89,840 **Net Impact** **£** (Increase - Decrease) £134.972

Key: **Annual Cost: Constant Prices** **(Net) Present Value**

Evidence Base
for Summary Sheets

1. PROPOSAL

1.1 Give effect in UK law and implement Directive 2006/43/EC ("the Audit Directive") and Directive 2006/46/EC in relation to Lloyd's syndicate and aggregate accounts; and update the Lloyd's accounting regulations to take account of amendments made to the Companies Act 1985 since 2004, and the replacement of that Act by of the Companies Act 2006.

1.2 This impact assessment will focus on the costs and benefits of making these amendments in relation to Lloyd's syndicate and aggregate accounts.

2. THE AUDIT DIRECTIVE

OBJECTIVES OF THE AUDIT DIRECTIVE

2.1 The overall objective of the Audit Directive is to clarify the duties of statutory auditors in Member States and to provide for their independence and ethical standards. It also introduces a requirement for external quality assurance; provides for public oversight of the audit profession, including third country auditors; and improves cooperation between oversight bodies in the EU.

2.2 The Department for Business, Enterprise and Regulatory Reform (BERR) has already conducted a public consultation on the impact of this Directive on audit firms. This Impact Assessment evaluates the impact of these measures on Lloyd's syndicate and aggregate accounts.

2.3 Unlike in some member states, the existing UK framework for statutory audits of entities already provides for a significant proportion of the areas covered by the Audit Directive. Examples include the Directive's proposals on:

● Education and qualifications (Articles 3-14);

● Registration provisions (Articles 15-20);

● Ethics (articles 21-25)

PROVISIONS REQUIRED IN RELATION TO LLOYDS

2.4 There are some areas where specific additional provisions need to be made in the legislative framework in relation to Lloyd's. These are:

(a) Audit reporting.

Article 28 of the Audit Directive requires the audit to be signed by the statutory auditor, except in limited circumstances. HM Treasury intends to provide for this requirement in regulations 11 to 13 of the draft Insurance Accounts Directive (Lloyd's Syndicate and Aggregate

Accounts) 2008 in relation to syndicate accounts, and regulations 22 to 24 (in relation to the aggregate accounts).

(b) Appointment of the Auditor.

Article 37 of the Audit Directive requires the appointment of an auditor to be by persons independent of the executive organs of the organisation. At present the auditor of the syndicate accounts is appointed by the managing agent, and the auditor of the aggregate accounts is appointed by the Council of Lloyd's.

HM Treasury intend to provide for this in relation to syndicate accounts by requiring the members of Lloyd's who participate in a syndicate to appoint a statutory auditor, and in relation to aggregate accounts by requiring the members of the Society of Lloyd's to appoint the auditor.

(c) Dismissal and resignation of auditors.

Article 38.1 of the Audit Directive requires Member States to ensure that statutory auditors or audit firms are only dismissed where there are proper grounds.

In line with the approach taken for Building Societies, I&Ps and Friendly Societies, HM Treasury intends to provide for this requirement by granting various persons a right to apply to the High Court for a remedy.

In relation to syndicate accounts the right to apply to the High Court has been given to members of the Syndicate, the Society of Lloyd's and to the FSA. The equivalent provisions in relation to aggregate accounts are given to any member of the Society or to the FSA.

(d) Notification of resignation of auditor.

Article 38.2 of the Audit Directive requires both the auditor and audited entity to give notice in any case where the auditor ceases to hold office before the end of his term, and to provide an adequate explanation therefore. At present section 344 of the Financial Services and Markets Act 2000 does not require an explanation to be given if the auditor does not consider this necessary. HM Treasury intends to implement this obligation in relation to Lloyd's in Schedule 1, paragraphs 17 and 18 (in relation to syndicate accounts), and Schedule 3, paragraphs 9 and 10 (in relation to the aggregate accounts).

(e) Remuneration of the Auditor

Article 49 of the Audit Directive requires disclosure of total fees charged by the auditor for statutory audit of the accounts, and other services. HM Treasury therefore intends to implement this requirement by regulation 4(4) (syndicate accounts), regulation 17(6) (aggregate accounts) and Schedule 2 to the regulations.

BACKGROUND TO THE AUDIT DIRECTIVE

2.5 The Audit Directive was adopted on 17 May 2006 and published in the Official Journal of the European Communities on 9 June 2006. The purpose of this Directive is "to improve the credibility of financial information and to strengthen protection in the European Union against financial scandals". The full text can be found at www.europa.eu.int.

3. DIRECTIVE 2006/46/EC ON COMPANY REPORTING

OBJECTIVES OF THE DIRECTIVE

3.1 The Directive on company reporting seeks to "further enhance confidence in the financial statements and annual reports published by European companies to provide shareholders and other stakeholders (e.g. employees, suppliers and Members) with reliable, complete, and easily accessible information".

3.2 The Directive amends Council Directives:

- 78/660/EC on the annual accounts of certain types of companies ("the Fourth Directive"),
- 83/349/EEC on consolidated accounts ("the Seventh Directive"),
- 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions ("the Bank Accounts Directive")
- 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings ("the Insurance Accounts Directive").

PROVISIONS REQUIRED IN RELATION TO LLOYD'S

3.3 The amendments required by the Directive are being implemented in provisions in the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("the BERR Regulations") which will be applied to Lloyd's.

3.4 However, there are two specific areas where provisions need to be made to the legislative framework in relation to Lloyd's:

(a) Off-balance sheet arrangements – Paragraph 6 of Article 1 of the Directive requires details to be given of the nature and purpose of off-balance sheet arrangements, and transactions with related parties. HM Treasury intends to implement these requirements in paragraph 7 of Schedule 1 of the draft Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) in relation to syndicate accounts, and paragraph 1 of Schedule 3 (in relation to aggregate accounts).

(b) Related party transactions - Paragraph 6 of Article 1 of the Directive also requires information to be provided on related party transactions. This obligation is implemented in the BERR Regulations. HM Treasury intend to modify these regulations in their application to Lloyd's syndicates to provide for additional information to be disclosed in the syndicate accounts. These accounts will be required to identify any related parties of the managing agent of the syndicate who are brokers, and, where material transactions have been entered into with such brokers otherwise than on market conditions, to disclose the amount of transactions transacted with such brokers during the year.

BACKGROUND TO DIRECTIVE 2006/46/EC ON COMPANY REPORTING

3.5 As part of the European Commission’s broader program of company law reform it published an Action Plan in May 2003 containing some legislative measures aimed at enhancing the credibility of financial statements and annual reports published by European Companies.

3.6 This directive focuses on the linked objectives of increasing confidence in corporate governance frameworks and improving investor confidence through increased transparency and better information on companies.

3.7 The measures in the directive contribute to several of the aims that the Government believes to be important to industry, namely:

- increased financial stability and market confidence
- extending investment opportunities across the EU
- improving access to capital by companies across borders

3.8 Research by academics including “The Benefits of Transparency” by Christian Leuz, Capital Ideas Journal, July 2006 and “International Differences in the Cost of Equity Capital”, by Hail, Luzi and Leuz, December 2005 - concludes that there is a link between transparency and cost of capital of certain institutions. They found that firms from countries with more extensive disclosure requirements, stronger securities regulation and stricter enforcement mechanisms (as enabled by a high quality legal infrastructure) had significantly lower cost of capital.

3.9 This is because where there are increased disclosure requirements, investors are better placed to assess the risks and benefits of their investments and so enable them to make more efficient investment decisions.

3.10 The requirements of this Directive are broadly consistent with existing UK law and practice. Informal stakeholder soundings in response to the proposals indicate that Government should support its broad principles. The Department for Business Enterprise and Regulatory Reform (BERR) has met with representatives and stakeholders of entities affected by the Directive to discuss the implementation proposals.

4. ADDITIONAL AMENDMENTS REQUIRED

4.1 To take account of the amendments to the Companies Act 1985 since the 2004 regulations came into force, and its replacement by the Companies Act 2006, several changes are required:

a) Disclosure to Auditors – section 234ZA imposes a duty to make a statement that the director has provided all relevant audit information and exercise all due care, skills and diligence. HM Treasury intends to apply this provision in paragraph 14 of part 2 of Schedule 1 to the draft regulations.

b) Notes to Account, directors' remuneration – to apply section 413 of the Companies Act 2006 to managing agents, HM Treasury intends to extend the requirement for notes in the syndicates annual accounts to include information about advances, credits and guarantees made to or on behalf of directors of a managing agent which have been charged to a syndicate (see Schedule 1 paragraph 6).

c) Managing Agent Reports – the provisions set out in Directive 2003/51/EC ("The Modernisation Directive") in relation to annual reports apply to insurance undertakings such as Lloyd's. Paragraphs 8(2) and 9 of Schedule 1, and paragraphs 2 and 3 of Schedule 3 to the new regulations set out these requirements.

5. OPTIONS

OPTION	**AVERAGE COST PER ANNUM (PRESENT VALUE)**	**AVERAGEBENEFITS PER ANNUM (PRESENT VALUE)**
a) No Intervention	-	-
b) Amend the existing framework in order to implement the Directives. In order to make the changes transparent we will revoke the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 and lay the new regulations.	£27,600 - £45,600	£ 1.1 m

6. RISK, UNCERTAINTY AND UNINTENDED CONSEQUENCES

6.1 The provisions in Directives 2006/43/EC and 2006/46/EC arose because the Commission had concerns that investor confidence had been badly compromised following corporate scandals such as WorldCom, Enron and Parmalat. The Commission's view was that making financial arrangements more transparent and requiring companies to give information relevant to good corporate governance would reduce the risk of future corporate scandals in Europe.

6.2 Analysis of the cost of the loss in investor confidence based on the fall in stock market wealth following the failure of Enron and WorldCom in July 2002 was estimated at 0.36% of Gross Domestic Product or $38.2 billion in the first year. (See Graham, Carol/Litan, Robert/Sukhtanker, Sandip 2002 – "The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance").

6.3 It is therefore imperative that any reasonable steps that are taken by the Commission to mitigate this risk are treated constructively.

7. WHO WILL BE AFFECTED

7.1 Managing Agents, all accountancy firms who carry out statutory audits for Lloyd's syndicate and aggregate accounts, and all Lloyd's members.

8. EQUITY AND FAIRNESS

8.1 The Government considers that the measures introduced will not have a disproportionate impact on the groups identified.

9. IMPACT ON SMALL FIRMS

9.1 The Government's view is that there will not be a disproportionate impact on small business.

10. IMPACT ON COMPETITION

10.1 The requirements will affect all accountancy firms that carry out statutory audits for Lloyd's syndicate and aggregate accounts. It is not expected that the legislation will affect any auditors more than others or restrict innovation. However, the increase any increase in transparency may increase competition between syndicates and make the Lloyd's market more efficient.

Specific Impact Tests - Checklist

Type of testing undertaken	***Resultsin Evidence Base? (Y/N)***	***Results annexed? (Y/N)***
Competition Assessment	*Y*	*N*
Small Firms Impact Test	*Y*	*N*
Legal Aid	*N/A*	*N/A*
Sustainable Development	*N/A*	*N/A*
Carbon Assessment	*N/A*	*N/A*
Other Environment	*N/A*	*N/A*
Health Impact Assessment	*N/A*	*N/A*
Race Equality	*N*	*Y*
Disability Equality	*N*	*Y*
Gender Equality	*N*	*Y*
Human Rights	*N/A*	*N/A*
Rural Proofing	*N/A*	*N/A*

Annexes

A

OPTION	Average COSTS PER ANNUM (Present Value)	AverageBENEFITS PER ANNUM (Present Value)
A	-	-
B	£27,600 - £45,600	£ 1.1 m

B PRESENT VALUE CALCULATIONS

BENEFITS (OPTION B)

YEAR	DISCOUNT FACTOR	BENEFIT
T_0 2008	3.5%	£ 1.1 m
T_1 2009	3.5%	£ 1.06 m
T_2 2010	3.5%	£ 1.03 m
T_3 2011	3.5%	£ 0.99 m
T_4 2012	3.5%	£ 0.96 m
T_5 2013	3.5%	£ 0.93 m
T_6 2014	3.5%	£ 0.89 m
T_7 2015	3.5%	£ 0.86 m
T_8 2016	3.5%	£ 0.84 m
T_9 2017	3.5%	£ 0.81 m
T_{10} 2018	3.5%	£ 0.78 m
	Total:	£10.25 m

TOTAL BENEFIT (PRESENT VALUE) = £10.25 m
AVERAGE ANNUAL BENEFIT = £1.1m

COSTS (OPTION B)

YEAR	DISCOUNT FACTOR	COSTS
T_0 2008	3.5%	£17,150 - £35,150
T_1 2009	3.5%	£16,570 - £33,962
T_2 2010	3.5%	£16,006 - £32,813
T_3 2011	3.5%	£15,467 - £31,702
T_4 2012	3.5%	£14,945 - £30,630
T_5 2013	3.5%	£14,440 - £29,597
T_6 2014	3.5%	£13,952 - £28,595
T_7 2015	3.5%	£13,480 - £27,628
T_8 2016	3.5%	£13,024 - £26,693
T_9 2017	3.5%	£12,583 - £25,790
T_{10} 2018	3.5%	£12,158 - £24,918
		£159,775 - £327,475
	Total:	

TOTAL COSTS (PRESENT VALUE) = £159,775 - £327,475
AVERAGE ANNUAL COST = £27,600 - £45,600

ADMINISTRATIVE BURDENS
TOTAL COSTS EXCLUDING SET-OFF

	YEAR	DISCOUNT FACTOR	COSTS
T_O	2008	3.5%	£27,600 - £45,600
T_1	2009	3.5%	£26,038 - £43,019
T_2	2010	3.5%	£25,765 - £42,568
T_3	2011	3.5%	£24,892 £41,127
T_4	2012	3.5%	£24,051 - £39,736
T_5	2013	3.5%	£23,239 - £38,395
T_6	2014	3.5%	£22,453 - £37,096
T_7	2015	3.5%	£21,694 - £35,842
T_8	2016	3.5%	£20,959 - £34,629
T_9	2017	3.5%	£20,250 - £33,457
T_{10}	2018	3.5%	£19,566 - £32,326
			£256,507 - £423,795
		Total:	

COSTS EXCLUDING SET-OFF (PRESENT VALUE) = £256,507 - £423,795

ADMINISTRATIVE BURDENS
SET-OFF

	YEAR	DISCOUNT FACTOR	REDUCTION IN COSTS
T_O	2008	3.5%	£ 10,450
T_1	2009	3.5%	£ 10,097
T_2	2010	3.5%	£ 9,755
T_3	2011	3.5%	£ 9,425
T_4	2012	3.5%	£ 9,106
T_5	2013	3.5%	£ 8,799
T_6	2014	3.5%	£ 8,501
T_7	2015	3.5%	£8,214
T_8	2016	3.5%	£7,936
T_9	2017	3.5%	£7,667
T_{10}	2018	3.5%	£7,408
			£97,358
		Total:	

SET-OFF (PRESENT VALUE) = £97,358

KEY ASSUMPTIONS AND FACTS

Syndicate accounts

- There are **75 syndicate accounts** as of January 2008.

● Accountant's fees per 4-hour day (£120-£200). Based on hourly rate of £30 per hour for small Enterprises and £50 per hour for Medium – Large.

● Accountant's fees per 8-hour day (£240 -£400). Based on hourly rate of £30 per hour for small Enterprises and £50 per hour for Medium – Large.

● Members of Lloyd's who participate in a syndicate appoint the statutory auditor at the syndicates at Annual General meeting.

Aggregate accounts

● Accountant's fees per 4-hour day (£120-£200). Based on hourly rate of £30 per hour for small Enterprises and £50 per hour for Medium – Large.

● Accountant's fees per 8-hour day (£240 -£400). Based on hourly rate of £30 per hour for small Enterprises and £50 per hour for Medium – Large.

● Members of the Society of Lloyd's appoint the auditor at the Annual General meeting.

COST/BENEFIT COMPARISONS

OPTION A (Cost/Benefit Comparison)

There are no benefits to failing to implement these directives. On the contrary, the Lloyds market might suffer from a lack of confidence. Not implementing the directives would also put the UK at risk of infraction proceedings from the EU.

OPTION B (Cost/Benefit Comparison)

Costs

The main effects of implementing the directives are that audit entities must disclose the total fees charged for the statutory audit of the accounts, and other services. Additional reporting on off-balance sheet arrangements and related party transactions may also be required. As such these costs are classified as administrative burdens.

It is likely that audit entities will need to perform extra checks to ensure that all non-audit work has been disclosed and that the work has been correctly valued at arm's length valuations. This may require an independent auditor other than the one who had performed the services in question.

Costs based on accountants fees for 1 ½ days work.

Small syndicated Accounts =	£30 X 12 hours X 75	= £ 27,000
Large syndicate Accounts =	£50 X 12 hours X 75	= £ 45,000
Annual Accounts =	£ 50 X 12 X 1	= £ 600

However, the off-setting measure of revoking the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 and replacing them with the more accessible form of the new regulations should reduce the administrative burdens. The reduction is based on the assumption that an hour of compliance and accounts staff time will be saved per account per year.

Syndicate Accounts = £137.5 x 1 hour x 75 = £ 10,312.5

Aggregate Account = £137.5 x 1 hour x 1 = £ 137.5
= £ 10,450

Therefore, the net effect of the legislation on administrative burdens in 2007 prices = £243,625 - £ 97,358 = £ 146,267

Discounting to 2005 prices gives = £ 224,812 – £89,840 = £ 134,972

Benefits

The main beneficial effect of the legislation will be an increase in transparency, enabling members to evaluate syndicates more effectively. Even if this only increases the overall return on syndicate investments' by 0.005% this would equate to £1.1m.

EQUALITY ASSESSMENTS

The legislation should have no impact on race, disability or gender equality.

ISBN 978-1-84532-510-7

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