

## *Market Bulletin*

**LLOYD'S**

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Attached to this bulletin is a report produced by the Capacity Markets Department which summarises and reviews activity in the 2002 capacity transfer season, including the auctions and bilateral arrangements, capacity offers, conversion and minority buy-outs. The report is being sent for information to all underwriting agents, corporate members, recognised accountants and market associations, including the ALM.

If you have any queries about the contents of the report, please contact Jonathan Rees (telephone 020 7327 6225, email [jonathan.rees@lloyds.com](mailto:jonathan.rees@lloyds.com)) or Richard Miller (telephone 020 7327 5897, email [richard.a.miller@lloyds.com](mailto:richard.a.miller@lloyds.com)).

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# CAPACITY TRANSFER IN 2002

## 1 Introduction

1.1 This report summarises activity in the 2002 capacity transfer season including:

- capacity auctions
- bilateral arrangements
- capacity offers
- minority buy-outs
- conversion schemes

1.2 The general approach adopted in 2002 by Market Supervision was, as in 2000 and 2001, to make as few changes as necessary to the rules governing capacity transfer, on the basis that the arrangements now in place since 1999 are both effective and well understood. Changes were, however, introduced after appropriate consultation to reduce the bilateral timetable from four to two days and to make the consequential changes to rules required by the Financial Services and Markets Act 2000 coming into force and the FSA's formal assumption of its regulatory responsibilities on 1 December 2001.

1.3 The appendices to this report present tabular and graphical information on the transfer of capacity as follows:

Appendix 1	Capacity transfer 2000 to 2002
Appendix 2	Summary of auction activity 1999 to 2002
Appendix 3	Offer summary
Appendix 4	Capacity offers in 2002
Appendix 5	Minority buy-out applications in 2002

The data in this report has been compiled with the assistance of the Members' Service Unit.

## 2 Chairman's Strategy Group and Capacity Transfer

2.1 To facilitate the implementation of its other capital structure proposals, the Chairman's Strategy Group (CSG) recommended a transition be made from the current basis of capital provision, based on the standard agency agreements and direct participation of third party capital, to a new basis in which all agents and syndicates would become integrated Lloyd's vehicles (ILVs). The approach to transition suggested by the CSG was "sale and leaseback", a deferred buy-out of all third party capacity's rights of tenure with effect from 1 January 2003.

- 2.2 Consultation, however, elicited clear feedback that the sale and leaseback proposal should not be taken further. Instead, it was proposed and agreed that:
- the capacity offer and minority buy-out rules should remain unchanged;
  - that new ways of structuring capacity offers should be recognised and accommodated under existing or, if necessary, amended rules; and
  - that consideration should be given to the introduction of limited tenancy capacity in 2002 for the 2003 year of account, whereby agents would be permitted to offer capacity with finite security of tenure which would, at the end of its term, revert for no consideration to the managing agent.

Full details of the CSG's proposals in respect of capacity transfer, which were subsequently approved at the EGM in September 2002, are set out in sections 4.3 to 4.7 of the CSG's consultation document issued in July 2002.

### **3 Auction Timetable**

- 3.1 Following consultation, it was agreed that the auction "season" for 2002 should be three auctions scheduled as follows:

Auction 1	17 and 18 September
Auction 2	1 and 2 October
Auction 3	10 and 11 October

This followed the 2001 precedent of a season of three auctions but the auctions in 2002 were held a little later in the year, following the EGM held on 12 September to consider the CSG proposals, and over a shorter period than in previous years.

### **4 Auctions and Bilateral Transactions**

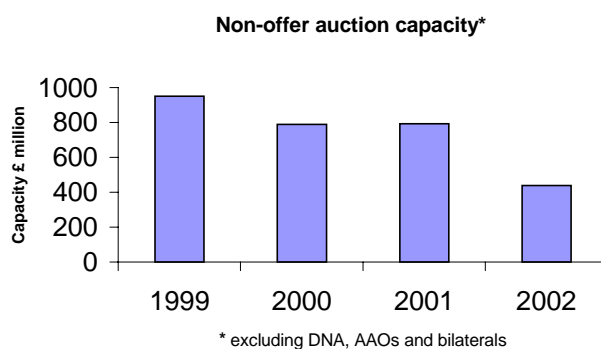
#### *Activity in 2002*

- 4.1 The volume of capacity transferred in 2002 was significantly lower than in previous years. In 2002 a total of £467 million of capacity transferred through the auction compared with £1,059 million in 2001 (see Appendix 1). Set out in Appendix 2 is a graph showing the capacity subscribed for, tendered and allocated at each auction over the past four years.
- 4.2 As in 2001, only one bilateral arrangement took place in 2002 but, unlike in 2001, there was no mandatory interaction with the auction. In 2002 a shortened bilateral timetable, of the type used in the second auction in 2001, was adopted for all auctions.
- 4.3 In the Deceased Names' Auction (DNA), held on 10 and 11 December 2002, £27 million of capacity was transferred. Included in the DNA, with the consent of the Auction Official, were transactions in limited tenancy capacity on syndicate 33 which

accounted for £19 million of the £27 million transferred. The application of the ‘no-trading’ rule was clarified to allow members who had successfully tendered syndicate 33’s conventional capacity in the auctions held in September and October 2002 to choose whether to subscribe for that syndicate’s limited tenancy capacity in the DNA.

4.4 In 2000 Council decided to allow estates of deceased members that had been unable to make use of the DNA to achieve value, provided the arrangements to transfer the capacity were made by 31 December in the relevant year. In 2002, as in 2001, this facility was not used.

4.5 2002 saw a significant decline in the capacity transferred through the auctions other than by acceptance of announced auction offers (AAOs). Of the £467m of capacity transferred through the auctions £28m was via AAOs and £439 was outside of the AAOs (compared with £255m and £792m respectively in 2001). The reduction in AAO volume reflects to some extent the lower number of mandatory offers made in 2002 (compared with 2001) and increasing frequency of formal offers in 2002.



## 5 Capacity Offers

5.1 The 2002 season produced nine offers. Four were formal offers and five announced auction offers. One of these offers received 100% acceptances (compared with two in 2001). Three of the formal offers and three of the AAOs led to applications for minority buy-outs.

5.2 Appendix 3 lists those syndicates that were the subject of an offer in 2002 and Appendix 4 gives further details on each of the offers made in 2002.

### *Formal offers*

5.3 Three of the four formal offers made in 2002 were voluntary offers and as such were able to innovate in certain respects. Offerors were for example able to introduce conditionality with regard to levels of acceptance (usually linked to minority buy-out thresholds) and “stepped” pricing, whereby the ultimate offer price was linked to levels of acceptance received. In one case, that of Amlin’s offer for capacity on syndicate 2001, the offer included (for the first time since 1998) an optional share consideration and a limited tenancy capacity arrangement (see 2.2 above) forming part of the offer terms.

## AAOs

- 5.4 Four of the five AAOs were made to comply with obligations to make offers that arose in the 2001 season. Three mandatory offers resulted in successful applications for minority buy-outs and the fourth was accepted by the single remaining unaligned member of the syndicate.

## *Offer activity in 2003*

- 5.5 In 2002 only one new obligation arose to make a mandatory offer, that of SVB in respect of capacity on syndicate 1007. The offer will be made in 2003 (see Appendix 3). By comparison eight obligations arose in 2001, and thirteen in 2000.

## 6 **Minority Buy-outs**

### *Buy-outs in 2002*

- 6.1 Six of the seven syndicates that achieved 100% alignment of capacity in 2002 used the minority buy-out procedure (see Appendix 5). One syndicate, Brit 2987, became fully aligned by agreement with the single, unaligned member.
- 6.2 All six applications to effect minority buy-outs during the year were successful.

## 7 **Conversion Schemes**

- 7.1 No conversion schemes were promoted in 2002. A number of private arrangements took place and are included in the figures in Appendix 1.

## CAPACITY TRANSFER 2000 to 2002

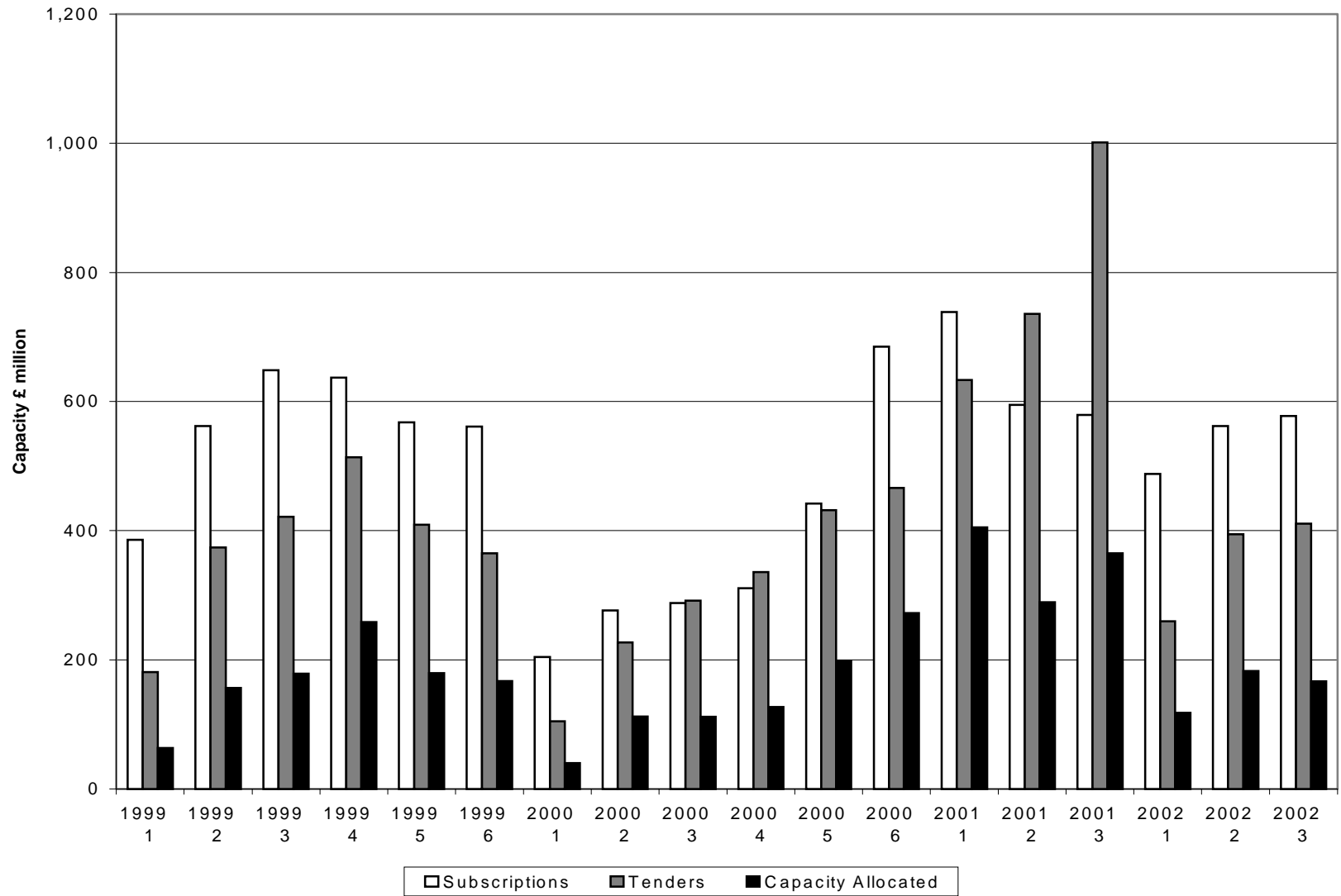
<b><u>Transfer Summary</u></b>	<b>2002 Capacity £m</b>	<b>2001 Capacity £m</b>	<b>2000 Capacity £m</b>
Auction activity			
Announced auction offers (AAOs)	28	255	66
Auction (excluding DNA <sup>1</sup> , AAOs & bilaterals)	439	792	790
Interaction with bilaterals	---	12	6
Total auction	<u>467</u>	<u>1,059</u>	<u>862</u>
Bilaterals (excluding interaction)	5	12	43
Total auction and bilaterals	<u>472</u>	<u>1,071</u>	<u>905</u>
Formal offers	286	---	11
Conversion	4	20	73
Total transferred	<u><u>762</u></u>	<u><u>1,091</u></u>	<u><u>989</u></u>

**Offer summary**

	<b>No.</b>	<b>2002 Capacity £m</b>	<b>No.</b>	<b>2001 Capacity £m</b>	<b>No.</b>	<b>2000 Capacity £m</b>
Voluntary	4	285	1	137	1	11
Mandatory	5	29	8	118	11	66
	9	<u>314</u>	9	<u>255</u>	12	<u>77</u>

<sup>1</sup> Capacity transferred through the DNA was: £27m in 2002; £4m in 2001; and £7m in 2000.

**Summary of Auction Activity 1999 to 2002**  
(excluding Deceased Names Auctions)



## OFFER SUMMARY

**1. Mandatory offers deferred from 2001 and made during 2002**

<u>Syndicate</u>	<u>Agent</u>	<u>Status</u>
340	St Paul	Obligation satisfied by AAO in auction 2
382	Hardy	Obligation satisfied by formal offer made in July 2002
435	Faraday	Obligation satisfied by AAO in auction 2
1241	SVB	Obligation satisfied by AAO in auction 1
2987	Wren	Obligation satisfied by AAO in auction 3

**2. Voluntary offers made in 2002**

<u>Syndicate</u>	<u>Agent</u>	<u>Status</u>
587	Chaucer	AAO made in auction 1
1003	Catlin	Formal offer made in August 2002
2001	Amlin	Formal offer made in August 2002
2488	ACE	Formal offer made in July 2002

**3. Mandatory offer obligations incurred and satisfied during 2002**

None

**4. Mandatory offer obligations incurred during 2002 and deferred to 2003**

<u>Syndicate</u>	<u>Agent</u>	<u>Status</u>
1007	SVB	Obligation incurred as a result of drop

**5. Syndicates where the mandatory offer obligation has been waived by the members**

994 (Greenwich)



## CAPACITY OFFERS IN 2002

Offeror	Managing Agent	Syndicate	Offer price  pence	Offer type Formal / AAO <sup>1</sup>	Auction(s) in which AAO took place	Projected 2003 stamp  £m	Offeror's (and associates) capacity pre-offer  % stamp	Amount under offer <sup>2</sup>  £m	Capacity surrendered under the offer  % of offer	Offeror's (and associates) capacity exclusively as a result of the offer  % stamp
Camperdown	St Paul	340	6.0	AAO	2, 3	100 <sup>3</sup>	92.15	7.85	95.81	99.67
Hardy	Hardy	382	6.8 <sup>4</sup>	Formal		100	79.77	20.23	2.92	80.36
Faraday	Faraday	435	5.5 / 20.0 <sup>5</sup>	AAO	2	400	96.74	13.03	68.27	98.97
ALIT	Chaucer	587	2.0	AAO	1	96	94.67	5.12	2.21	94.79
Catlin	Catlin	1003	35.0	Formal		430 <sup>6</sup>	79.25	89.35	87.98	97.50
SVB	SVB	1241	25.0	AAO	1	169 <sup>3</sup>	99.73	0.45	86.88	99.96
Amlin	Amlin	2001	20.0 <sup>7</sup>	Formal		800 <sup>8</sup>	72.29	221.69	91.83	97.74
ACE	ACE	2488	35.0 / 40.0 <sup>9</sup>	Formal		900 <sup>10</sup>	99.60	3.62	79.57	99.92
Brit	Brit	2987	13.5	AAO	3	500	97.78	11.11	100.00	100.00

<sup>1</sup> AAO: Announced Auction Offer.

<sup>2</sup> Figures adjusted for pre-emptions where appropriate.

<sup>3</sup> 2002 capacity.

<sup>4</sup> 6.8p after pre-emption, 12.6p before pre-emption.

<sup>5</sup> Offer price of 5.5p per £1 of capacity or 20.0p if over 50 per cent of the outstanding capacity was tendered.

<sup>6</sup> Combined capacity for syndicates 1003 & 2003.

<sup>7</sup> Share offer with cash alternative of 20p per £1 of capacity, both with the retention of the right to participate for the 2003 year of account with a premium limit of 50p.

<sup>8</sup> Before pre-emption.

<sup>9</sup> Offer price of 35p per £1 of capacity or 40p if 75% of the outstanding capacity was tendered.

<sup>10</sup> Before de-emption.

## MINORITY BUY-OUT APPLICATIONS IN 2002

Managing Agent	Offeror	Syndicate	Buy-out price	Projected 2003 stamp	Capacity under managing agent's control pre-offer	Capacity acquired under the offer	Controlled capacity prior to buy-out application	Application successful <sup>1</sup>
			pence	£m	% of stamp	% of offer	% of stamp	Yes / No
St Paul	Camperdown	340	6.0	100 <sup>2</sup>	92.15	95.81	99.69	Yes
Faraday	Faraday	435	20.0 <sup>3</sup>	400	96.74	68.27	99.36	Yes
Catlin	Catlin	1003	35.0	430 <sup>4</sup>	79.25	87.98	97.50	Yes
SVB	SVB	1241	25.0	169 <sup>2</sup>	99.73	86.88	99.96	Yes
Amlin	Amlin	2001	20.0 <sup>5</sup>	800 <sup>6</sup>	72.29	91.83	97.74	Yes
ACE	ACE	2488	40.0 <sup>7</sup>	900 <sup>8</sup>	99.60	79.57	99.92	Yes

<sup>1</sup> All buy-out applications were determined by the Business Conduct Committee, a committee of the Lloyd's Regulatory Board.

<sup>2</sup> 2002 capacity.

<sup>3</sup> Offer price of 5.5p per £1 of capacity or 20.0p if over 50 per cent of the outstanding capacity was tendered.

<sup>4</sup> Combined capacity for syndicates 1003 and 2003.

<sup>5</sup> Share offer with cash alternative of 20p per £1 of capacity, both with the retention of the right to participate for the 2003 year of account with a premium limit of 50p.

<sup>6</sup> Before pre-emption.

<sup>7</sup> Offer price of 35p per £1 of capacity or 40p if 75% of the outstanding capacity was tendered.

<sup>8</sup> Before de-emption.