

FROM: Andrew Moss, Director, Finance, Risk Management & Operations
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SUBJECT: NEW CENTRAL FUND CONTRIBUTIONS, MEMBERS' SUBSCRIPTIONS, PREMIUM LEVY AND OTHER CHARGES FOR 2004
SUBJECT AREA(S):
ATTACHMENTS:
ACTION POINTS: **Notification of subscriptions and payment dates**
DEADLINE:

1 Summary

- 1.1 Council has now approved the rates for Central Fund contributions, members' subscriptions for 2004 and entrance / application fees for 2004 as listed in Appendix I.
- 1.2 The premium levy, which was increased following September 11, 2001 to 2%, will cease at the end of 2003 having achieved its objective of boosting central assets.
- 1.3 The principal central charges are set out below and show a significant overall reduction from 2003.

	2003	2004
Premium levy *	2.00%	-
New Central Fund contributions	1.00%	1.25%
Members' subscriptions	0.25%	0.50%
	<u>3.25%</u>	<u>1.75%</u>
Callable Central Fund contributions	3.00%	3.00%

* 1% for UK motor & life business in 2003

2 Premium Levy

- 2.1 As noted above, the premium levy will cease at the end of 2003. The Lloyd's market has since 1997 been subject to a premium levy. This levy was used to repay a £285m syndicated bank loan required as part of the market's contribution to the 1996 *Reconstruction & Renewal* settlement. The loan was repaid in 2001. However, post-September 11 2001, in order to boost the central assets of the Society, the Council decided to continue the premium levy in 2002 and 2003 at an increased rate of 2% for most classes of business, except for life and UK motor business which was reduced to 1%. All premium levy receipts during 2002 and 2003 have been paid into the New Central Fund and the resulting in the growth in central assets has enabled the Council to cease the levy at the end of 2003 as planned.
- 2.2 The last collection will therefore be in January 2004 based on December 2003 signed premiums. The exception to this is in respect of motor, or any other, business not processed by XIS. The motor market pays the levy one quarter plus one month in arrears, the motor market will therefore continue to make monthly payments until April 2004 in respect of 2003 signed premiums.
- 2.3 As in previous years, there will be a refund of premium charges after the end of the year relating to return premiums for which credit has not already been granted by set-off against subsequent premium charges.

3 New Central Fund contributions

3.1 Annual contribution

- 3.2 The annual New Central Fund contribution rate payable by all members for the 2004 year of account is to increase by 0.25% to 1.25% of a member's syndicate premium limit in respect of each syndicate of which he is a member. This increase is to provide more flexibility for the New Central Fund following the expiry, at the end of 2003, of the current insurance arrangements.

3.3 New corporate members

- 3.4 New corporate members who meet the definitions set out below, will pay 2.5% for 2004, double the annual contribution rate. This reinstates a policy that new corporate members pay double the "standard" rate of contribution for their first three years of operation at Lloyd's. This policy is effective for the 2004 year of account and new corporate members, excluding those who commenced underwriting in 2003 or 2002, will pay a higher contribution. Within that category of member, it will not apply to:
- conversion vehicles which meet the current definition of a "successor corporate member" in the Membership (Entrance Fees and Annual Subscriptions) Byelaw – i.e. in broad terms, any vehicle which is 85% owned by converting Names
 - new corporate members which only participate on *existing syndicates*.
- 3.5 This leaves those new corporate members which join Lloyd's and establish / participate on one or more new syndicates thereby immediately accessing the Lloyd's brand, reputation and accumulated value of the Central Fund. It should be noted that if a new corporate member writes on a mix of existing and new syndicates, then the higher rate will only be payable in respect of its participations on new syndicates.

3.6 Where a newcomer to the market chooses to participate in the Lloyd's market by purchasing an existing corporate member that has reinsured to close all its liabilities, it will be required to pay the higher contribution in respect of its participations on new syndicates.

3.7 Qualifying Quota Share arrangements

3.8 Where syndicates enter into qualifying quota share arrangements outside the Lloyd's market further Central Fund contributions are payable at the relevant annual contribution rate if written premiums exceed allocated syndicate capacity. Interim charges will be made, where applicable, after 12 and 24 months and a final charge after 36 months. Interim charges relating to the 2001 and 2002 years of account will be advised shortly to syndicates for collection on 3 November 2003. Thereafter charges will be made each 1 April.

3.9 Callable contribution

3.10 Council also confirmed that the callable contribution will not exceed 3% of a member's syndicate premium limit in respect of each syndicate for the 2004 year of account.

3.11 Payment date

3.12 The annual Central Fund contribution for 2004 and the additional charge for new corporate members is payable in one instalment due on 1 April 2004 with up to 3% remaining callable at the discretion of Council. Syndicates will be given the option to make payments in US dollars. No VAT is levied on these Central Fund contributions.

4 Members' Subscriptions

4.1 The Council agreed that the rate for all underwriting members' subscriptions for 2004 should be 0.50% of allocated overall premium limits (OPL) payable in two instalments. The first at 0.25% of allocated OPL due on 5 January 2004 and the second instalment of 0.25% of OPL payable by 1 June 2004.

4.2 Members' subscriptions have been held at 0.25% since 2000, having been 0.50% in 1998 and 0.35% in 1999. In recent years the Corporation has absorbed substantial operating deficits at a time when the operating performance of the market has been poor, as shown in the table below:

Consolidated Revenue Account £m	1998	1999	2000	2001	2002
Members' subscriptions	51	35	25	28	32
Regulatory Levy			8	9	9
Other income	127	129	113	106	88
Operating income	178	164	146	143	129
Total expenses	(183)	(173)	(171)	(177)	(159)
Operating deficit	(5)	(9)	(25)	(34)	(30)

4.3 The operating deficits over this period reflect the substantial litigation defence costs incurred and, in 2002, the Corporation's £20m investment in Kinnect. Whilst the Corporation has been able to absorb these deficits partly through debt recoveries from

members who did not meet their 1996 *Reconstruction & Renewal* finality bills in full, which are not included in the table above, such recoveries are declining. As an operating deficit is expected for 2003 the Corporation cannot prudently continue to absorb such funding deficits which further reduce working capital. The annual members' subscription, which is sensitive to overall market capacity, has therefore been increased in 2004 to 0.50% aiming to ensure that the Corporation both breaks even at an operating results level and to provide greater financial flexibility. This will help to restore working capital and provide the ability to fund strategic market initiatives.

- 4.4 In 2004 the Corporation is expected to recommence contributions to the Lloyd's Pension Scheme after a pension contribution holiday of more than 10 years. This, together with proposed funding of Kinnect, estimated at £15m, is shown in the table below to illustrate how the increase in the members' subscription rate is accounted for.

Assuming capacity of £14.4bn	%	£m
2003 members' subscription	0.25%	36
Recommence employer contributions to pension scheme	0.04%	5
Proposed funding of Kinnect, subject to Council approval	0.10%	15
To provide financial flexibility	0.11%	16
2004 members' subscription	0.50%	72

- 4.5 The members' subscription is exempt from VAT
- 4.6 A bulletin concerning instructions for the payment of members' subscriptions, and the 2004 Franchise Performance & Risk Management Charge (which replaces the Regulatory Levy but will be charged on a similar basis), which will also be payable in two instalments, will be issued in late November. It is expected that the total income from this charge will be approximately £12m in 2004, compared to £9m received through the Regulatory Levy in 2003.

5 Financial Services Compensation Scheme

- 5.1 The FSA is considering whether or not Lloyd's should be brought within the Financial Services Compensation Scheme ("FSCS"). Lloyd's is committed to the protection of policyholders and believes that the Central Fund which has grown significantly over recent years already offers adequate protection. Indeed, Lloyd's goes far beyond the minimum protection provided by the FSCS and seeks to ensure that all policyholders receive 100% of any claim that a Lloyd's insurance business is unable to meet compared to the 90% maximum under the FSCS. Consequently, we believe that it would not be appropriate for Lloyd's to be brought within the FSCS, and Lloyd's has made its position clear to the FSA during the consultation period. The FSA's formal decision will not be known until later in September. It is therefore necessary to reserve the right to recover the costs of Lloyd's contributions to the FSCS in respect of 2004 by a charge on relevant premiums. The current maximum contribution to the FSCS in respect of compensation costs is 0.8% of relevant net premiums. However, the actual charge would not be known until mid-2005. In the event that Lloyd's were to be brought within the FSCS, Lloyd's would review its interaction with Central Fund charges at that time.

6 Entrance / Application fees

6.1 The principal administrative fees payable by new entrants (excluding VAT) are set out in Appendix 1. These charges are unchanged from 2003.

7 Interest on overdue amounts

7.1 Interest on overdue accounts is chargeable at 5% above National Westminster Bank plc base lending rate.

Questions regarding this bulletin should be addressed to Philip Jones, Extn 5314 (e-mail philip.a.jones@lloyds.com)

This bulletin has been sent to all underwriting agents, Lloyd's advisers, direct corporate members and market associations.

Director, Finance, Risk Management & Operations

APPENDIX I

2004 SUBSCRIPTIONS, FEES AND CONTRIBUTIONS

	<u>2003</u>	<u>2004</u>
Central Fund contributions		
Standard rate	1% of allocated OPL	1.25% of allocated OPL
Rate for new corporates (excluding captives and conversion vehicles) underwriting on new syndicates	N/a	2.5% * of allocated OPL
* new corporates pay increased contributions for the first 3 years of operations.		
Callable contributions	Up to 3% of allocated OPL	Up to 3% of allocated OPL
Premium Levy	2% of signed premiums (1% for UK Motor & Life business)	No charge
Members' subscriptions	0.25% of allocated OPL	0.50% of allocated OPL
Members' Entrance fees		
Connected or associated Member	£1,500	No longer applicable
Widow or widower of Member	£1,125	No longer applicable
Vocational (working) Member	£750	No longer applicable
Corporate Member	£25,000	£25,000
New Money NameCo	£4,700	£4,700
New Money NameCo where the shareholders were formerly individual members of Lloyd's	£1,850	£1,850
Successor Corporate Member	£1,850	£1,850
Initial Application (conversion schemes)	£1,850	£1,850
Additional Subscriber NameCos (conversion schemes)	£420	£420
Member not falling into any of the above categories	£4,700	£4,700
Change in Controller (corporate member)	£150	£150
Change in Director (corporate member)	£150	£150

Following an amendment to the Membership Byelaw no individual shall be eligible to become an underwriting member on or after 6 March 2003 other than an individual who has at all times since ceasing to be an underwriting member been a non-underwriting member.

2004 SUBSCRIPTIONS, FEES AND CONTRIBUTIONS

	<u>2003</u>	<u>2004</u>
Underwriting Agent / Syndicate		
Application fees		
Change in Controller (underwriting agent)	£5,000	£5,000
New Underwriting Agent	£100,000	£100,000
New Syndicate	£50,000	£50,000
New Captive Syndicate	£20,000	£20,000