

**FROM:** Head, Market Reporting  
**LOCATION:** 86/G5  
**EXTENSION:** 5129  
**DATE:** 23 April 2004  
**REFERENCE:** Y3299  
**SUBJECT:** 2001 YEAR OF ACCOUNT DISTRIBUTION:  
CONTINUOUS SOLVENCY TRANSFERS – 2002 &  
2003 YEARS OF ACCOUNT  
**SUBJECT AREA(S):** As above  
**ATTACHMENTS:** Cash transfer statement  
**ACTION POINTS:** **Requirements for continuous solvency transfer**  
**DEADLINE:** **Declaration 30 April 2004**  
**Transfer from syndicate premium trust funds 14  
May 2004**

The Franchise Board has now considered and agreed proposals to permit continuous solvency transfers (CSTs) on the 2002 and the 2003 years of account to meet cash calls and loss payments. Any CST that is not applied to meet cash calls will be held in the personal reserve sub-fund (PRF) until closure of the 2002 year of account and / or 2003 year of account respectively and may be used towards meeting capital requirements within the 2005 coming-into-line exercise conducted later this year.

This CST is an extension of the transfer permitted last year when the Franchise Board agreed that members participating on the 2002 year of account could utilise, in part, 2002 year of account surpluses in respect of general business to meet cash calls (see market bulletin dated 15 April 2003 Y3038 “2000 Year of Account Distribution: Continuous Solvency Transfer Re. 2002 Year of Account”).

#### **Methodology to be utilised**

Managing agents may make a transfer in respect of a 2002 and 2003 year of account solvency surplus for general business from the sterling premiums trust funds (PTFs) and/or the Lloyd's Dollar Trust Funds (LDTFs) to the PRF.

The surplus available for transfer will be determined by reference to the cumulative annual accounting result declared up to 31 December 2003 on both the 2002 and 2003 years of account less the CST made in May 2003 in respect of the 2002 year of account. For prudence, the CST will be restricted to a maximum of 50% of the annual accounting result. Where 50% of the annual accounting result, less any previous CST released in calendar year 2003, is greater than the 31 December 2003 syndicate solvency result then the transfer will be restricted to the level of the available solvency surplus. In this regard the annual accounted profits declared at 12 and 24 months in respect of a profitable year of account will normally be lower than the solvency surplus, since the current valuation of liabilities rules for solvency permit recognition of profits with no deferral in respect of unearned premiums.

This methodology, rather than a flat rate percentage of stamp, enables the release to be syndicate specific. Furthermore, the utilisation of the annual accounting result, rather than the solvency surplus, recognises Lloyd's move towards statutory annual accounting and the subsequent changes to the calculations of solvency and capital.

### **Effect on solvency**

The CST will not have any effect on the 31 December 2003 solvency calculations as the members participating on the 2002 and 2003 years of account will already have received the benefit of the 2002 and 2003 surpluses within the solvency calculations as set out on the solvency statements issued on 7 April 2004. The CST therefore cannot be used towards clearing solvency shortfalls.

### **Next steps**

It will be for individual managing agents to decide on a syndicate by syndicate basis whether, and to what extent, a transfer is appropriate. In making this decision, managing agents will be exercising powers conferred on them by clause 14(b)(iv) of the PTD and clause 14(a)(ii) of the Lloyd's American Instrument (LAI) to direct the managing agent's trustees or the managing agent's dollar trustees (as the case may be) to transfer funds from the syndicate level PTFs and/or LDTFs. An agent must therefore act prudently and should ensure that it retains sufficient assets to cover its reasonable estimate of the liabilities of that part of the member's business being conducted by it. It should therefore be reasonably satisfied in making its decision that the retained assets will allow it to meet those liabilities as they are expected to fall due.

Market Reporting will shortly issue a cash transfer statement to each managing agent setting out the maximum CST which can be transferred using the above methodology.

In addition, where a managing agent proposes to make a transfer it must:

- i) prepare cash flow projections for the business of the syndicate in order to satisfy itself that the transfer of syndicate funds will not cause cash flow difficulties in the future;
- ii) complete and return the cash transfer statement (which will be issued to each managing agent under separate cover) to Sarah Smith by 30 April 2004 (attached is an example cash transfer statement managing agents will be requested to complete);

- iii) use a rate of exchange of \$1.79 : £1 in order to calculate the sterling equivalent of any cash transfer to be effected in US dollars.

Any cash to be transferred from the syndicate PTFs or LDTFs in respect of the 2002 and / or 2003 CST will be included for payment via Central Accounting Settlement for value on 14 May 2004. Managing agents must ensure that any CST is made in accordance with the profits in the underlying currency. Agents should not remit funds directly but should ensure that their Central Settlement Accounts have sufficient funds to support settlement on 14 May. The usual notifications will be issued.

### **Distribution DAM related Issues**

Within currency, CST will spend after 2001 profit related assets. 2003 CST will spend ahead of 2002 CST. If a surplus remains, CST will be converted, once again after 2001 profit related assets, to meet non-life debts in the alternative currency. Please note that CST can only be utilised to meet non-life PTF debts (these include MSU Charges and PTF Agent Expenses).

Following discussions with members' agents, it has been agreed that changes will be made to this year's Distribution Timetable. In order to minimise the conversion of assets within the DAM, including any CST, members will have the opportunity of submitting additional assets into Distribution before the allocation process commences. MSU will shortly provide a detailed timetable and a full explanation of these changes.

Members' agents and direct corporate members should also be mindful of the effect that the CST will have on final profits to be distributed next year when the 2002 year of account would be expected to close. By way of an example for **illustrative purposes** only:-

1. Capacity for 2002 account	£500,000
2. Expected profit on 2002 account (14% of capacity)	£70,000
3. 2002 CST in May 2003 (5% of capacity)	£25,000
4. 2002 CST in May 2004 (5% of capacity)	£25,000
5. CST used to meet loss payments	£40,000
6. Unspent CST from (May 2003 / 2004) (3 + 4 - 5)	£10,000
7. Balance of profit expected in 2005 (2-3-4)	£20,000
<b>8. Maximum profit available for distribution in 2005 from 2002 (6 + 7)</b>	<b>£30,000</b>

### **SRF Issues**

Lloyd's are currently in discussion with the Inland Revenue regarding the impact of the allocation of CST against earlier year losses, as this may reduce the amount of profit related assets available for transfer into the SRF from 2005. As soon as a decision is reached on this matter, it will be communicated to members' agents.

### **Life syndicates**

Life syndicates will not be able to make transfers of 2002 or 2003 year of account solvency surpluses.

**Taxation implications**

The Inland Revenue has confirmed that the CST will not bring forward the time at which the syndicate profits are taxed. Syndicate profits of the 2002 and / or 2003 years of account will still be taxed when they are declared, that is in income tax year 2005-06 and 2006-07 respectively for individuals and calendar year 2005 and 2006 for companies.

**Further information**

Any queries on the above should be addressed to Kevin Nethersell ext. 6253 – [kevin.nethersell@lloyds.com](mailto:kevin.nethersell@lloyds.com), Sarah Smith ext. 6420 – [sarah.smith2@lloyds.com](mailto:sarah.smith2@lloyds.com) or Mike Steer ext. 5709 – [mike.steer@lloyds.com](mailto:mike.steer@lloyds.com).

This bulletin has been sent to the compliance officer of all managing agents, members' agents, direct corporates and recognised auditors, and for information to all market associations including the ALM.

John Parry

## CASH TRANSFER STATEMENT

SYNDICATE NO. \_\_\_\_\_ MANAGING AGENT \_\_\_\_\_

	2002 Year of Account	2003 Year of Account
1. Cumulative Annual Accounting Results	<input type="text"/>	<input type="text"/>
2. Annual Accounting Result x 50%	<input type="text"/>	<input type="text"/>
3. Previously Released Continuous Solvency Transfer 2002 YoA (£)	<input type="text"/>	N/A
4. Amount available for release (Lesser of (1-2-3) or SR15 Result)	<input type="text"/>	<input type="text"/>
5. Transfer from syndicates Sterling Premiums Trust Fund	<input type="text"/>	<input type="text"/>
6. Transfer from Lloyd's Dollar Trust Fund *	<input type="text"/>	<input type="text"/>
7. <b>Total transfer in sterling</b> (*converted at 1.79) <b>(Must not exceed line 4)</b>	<input type="text"/>	<input type="text"/>

In accordance with the market bulletin dated 23 April 2004 entitled "2001 Year of Account Distribution: Continuous Solvency Transfers – 2002 & 2003 Years of Account" Ref [.....] the Board of Directors has prepared cash flow projections for the business of the 2002 and/or 2003 years of account of the Syndicate and based upon these projections, has decided to transfer the amounts as per lines 5 and/or 6 above into the Personal reserve Sub-Funds of the members who underwrote through the Syndicate for that year of account. These monies will be debited to the Syndicate's 2002 and/or 2003 years of account respectively on 14 May 2004.

The Board of Directors confirms that on the basis of the information available to it as at the date of this statement, the Board is satisfied that the above transfer is unlikely to result in a cash call on members of the Syndicate for the 2002 and/or 2003 years of account and that sufficient liquid resources exist to fund the transfer.

Further the Board of Directors confirms that no material adverse development has occurred since 31 December 2003, which affects the declared solvency surplus and annual accounting result.

Approved by the Board on \_\_\_\_\_

Signed \_\_\_\_\_ (Compliance Officer)

\_\_\_\_\_ (Director)

**PLEASE RETURN TO SARAH SMITH BY FAX TO 020 7327 6178 BY 30 APRIL 2004.**