

# MARKET BULLETIN

REF: Y4287

<b>Title</b>	Capacity Markets
<b>Purpose</b>	Proposals to Amend the Disclosure Requirements for Bilateral Arrangements
<b>Type</b>	Event
<b>From</b>	Chairman of the Capacity Transfer Panel
<b>Date</b>	4 June 2009
<b>Deadline</b>	17 July 2009
<b>Related links</b>	<p><b>Auction Guide</b>  <a href="http://www.lloyds.com/NR/ronlyres/2248481C-DFC3-4F05-8A9D-C1419A2FBF67/0/AuctionGuide2009.doc">http://www.lloyds.com/NR/ronlyres/2248481C-DFC3-4F05-8A9D-C1419A2FBF67/0/AuctionGuide2009.doc</a></p> <p><b>Bilateral Arrangements (2009) Rules</b>  <a href="http://www.lloyds.com/NR/ronlyres/7B7FF3EA-7B76-469F-968B-7E4DBD0F88B7/0/BilateralArrangementRules2009.doc">http://www.lloyds.com/NR/ronlyres/7B7FF3EA-7B76-469F-968B-7E4DBD0F88B7/0/BilateralArrangementRules2009.doc</a></p> <p><b>Bilateral Arrangements Byelaw</b>  <a href="http://www.lloyds.com/NR/ronlyres/F02595FF-3464-4E5B-A71D-44F6F887D029/0/March07ByelawBilateralArrangements.pdf#search='bilateral'">http://www.lloyds.com/NR/ronlyres/F02595FF-3464-4E5B-A71D-44F6F887D029/0/March07ByelawBilateralArrangements.pdf#search='bilateral'</a></p> <p><b>Auction Rules</b>  <a href="http://www.lloyds.com/NR/ronlyres/A0DDAAC-6DFF-4C35-9F7E-30CEA642251D/0/AuctionRules2009.doc">http://www.lloyds.com/NR/ronlyres/A0DDAAC-6DFF-4C35-9F7E-30CEA642251D/0/AuctionRules2009.doc</a></p>

## Introduction

The Capacity Transfer Panel (the “**Panel**”) in its May meeting concluded that the market should be consulted in relation to proposed amendments to the disclosure requirements for bilateral arrangements which are set out in the Auction Guide before the Panel makes a final decision on this matter ahead of the 2009 auction season.

## Background

Lloyd's rules for bilateral arrangements are set out in the Bilateral Arrangements (2009) Rules (the "**Rules**") which are issued annually and are accompanied with an annual explanatory guide (the "**Auction Guide**") (both of these documents can be found at the respective weblinks listed above).

A bilateral arrangement involves the sale and purchase of not less than £250,000 of capacity on a particular syndicate between two members. The Rules provide for a mandatory form of interaction between a bilateral arrangement and the auction process.

## Interaction and Disclosure of Bilateral Arrangements under the Rules and the Auction Guide

The mandatory form of interaction between bilateral arrangements and the auction process is designed to ensure that unsuccessful sellers of capacity on the syndicate that is the subject of the bilateral arrangement are able to sell their capacity to the party wishing to buy under the bilateral arrangement (provided that the unsuccessful sellers' subscription orders in the auction specify a price which is higher than the price fixed for the bilateral arrangement). Similarly, unsuccessful buyers of capacity on the syndicate that is the subject of the bilateral arrangement are able to buy capacity from the party wishing to sell under the bilateral transaction (provided that the unsuccessful buyers' tender orders in the auction specify a price which is lower than the bilateral arrangement price).

As a consequence of mandatory interaction, the disclosure procedures in relation to bilateral transactions, which were first introduced in 1998, do not require disclosure ahead of the auction other than where one of the parties has Relevant Information (as defined in the Auction Rules). The rules only impose an obligation to notify the Auction Office of a bilateral arrangement on Day 2 of the auction. As a consequence, most bilateral trades do not become public until the second day of the auction.

In practice, this allows parties to a bilateral arrangement to keep it confidential whilst ensuring that those buying and selling capacity in the auctions benefit from the bilateral arrangement to the extent that they are bidding for capacity at a higher price or selling at a lower price than the bilateral arrangement.

## Use of Bilateral Arrangements

It was originally envisaged that bilateral arrangements would be primarily used by managing agents but recently there has been some use of bilateral arrangements by members' agents to acquire capacity for their members. The Panel considered that it could be extremely difficult for members' agents to ensure that they properly fulfil their fiduciary obligations to members in circumstances where they are arranging a bilateral arrangement and acting on behalf of their members in the same auction. Notwithstanding that chinese walls can be put

in place within the members' agent, the members' agent could have information about syndicate capacity available at a particular price in the bilateral arrangement at the same time as its members, in the absence of that bilateral information, have instructed the members' agent to buy capacity in the auction at a higher price. In not sharing that information openly and transparently prior to the auction, a member's agent could be disadvantaging certain of its members. The Panel has therefore considered whether these difficulties would be overcome by requiring disclosure of the bilateral arrangement in advance of the auction in which it will interact.

### Consultation

The Panel concluded that it would like to receive the views of the market on –

1. whether there should be mandatory disclosure of all bilateral transactions prior to the auction in which they will interact (see the proposed amendments to the Auction Guide at Annex 1(A));
2. whether there should be mandatory disclosure of only those bilateral transactions which involve a members' agent prior to the auction in which they will interact (see the proposed amendments to the Auction Guide at Annex 1(B)); and
3. any general or specific observations on the question of mandatory disclosure of bilateral arrangements.

The Panel invites members, members' agents, managing agents and their respective associations to submit written responses to the numbered matters set out above and to the draft amendments in Annex 1 by no later than **17 July 2009**. Responses should be sent for the attention of Paul Thornton, Legal & Compliance (email [paul.thornton@lloyds.com](mailto:paul.thornton@lloyds.com)).

The Panel will consider the responses that have been sent to Lloyd's once the deadline has expired and will issue any changes to the Auction Guide by 7 August 2009.

Any parties that are considering entering into a bilateral arrangement in 2009 should consider the implications of a mandatory requirement to disclose a bilateral arrangement in advance of the auctions should the Panel decide to issue changes to the Auction Guide later this year.

**Annex 1(A)**

**Proposed Amendments to the Auction Guide**

**In the case where there is mandatory disclosure of all bilateral transactions prior to the auction in which they will interact:**

- (1) Paragraph 9.3 shall be deleted and replaced with the following text:

“Pursuant to 14.9 below there will be mandatory disclosure of all bilateral transactions prior to the auction in which they will interact by no later than noon on the penultimate working day before the start of the auction in which that bilateral arrangement will interact. Any Issuer who is a contact for a bilateral arrangement and has also entered bids on the relevant syndicate in the same auction should ensure that their compliance officer is able to respond to queries, if raised, by the regulators during both Day One and Day Two. A failure to satisfy any queries of the regulators may result in auction bids being withdrawn.”

- (2) Paragraph 14.9 shall be deleted and replaced with the following text:

“Parties to a bilateral transaction are required to make a disclosure to the Auction Office that the bilateral transaction will be entered in an auction by those parties and the disclosure shall include –

- i. the parties to the bilateral arrangement;
- ii. the auction in which the bilateral arrangement will be entered;
- iii. the syndicate concerned, the date and time the transaction will be submitted to the Auction Office;
- iv. the amount of capacity and the price to be paid in respect of each £1 of capacity which is the subject of the arrangement; and
- v. such other particulars as the Auction Official may require, whether generally or in relation to the particular arrangement.

The disclosure will be submitted by one of the parties to the bilateral transaction by no later than noon on the penultimate working day before the start of that auction. Failure to make such a disclosure will prevent such a transaction from being accepted by the Auction Office. In addition, parties to bilateral arrangements are subject to the same requirements under the auction rules in respect of disclosure and market conduct (see section 9).”

**Annex 1(B)****Proposed Amendments to the Auction Guide**

**In the case where there is mandatory disclosure of only those bilateral transactions which involve a members' agent as a party prior to the auction in which they will interact:**

- (1) Paragraph 9.3 shall be deleted and replaced with the following text:

“Bilateral arrangements create additional occasions for Issuers and other auction participants to be in possession of Relevant Information. Firm detailed information about a proposed bilateral arrangement will be Relevant Information. Subject to 14.10 below, it will be for those involved in any discussions to judge the point at which the arrangements are sufficiently firm for their knowledge of the position to constitute Relevant Information.

Paragraph 14.10 below requires mandatory disclosure of bilateral transactions where a members' agent has been involved in arranging that transaction by no later than noon on the penultimate working day before the start of the auction in which that bilateral arrangement will interact.

Any Issuer who is a contact for a bilateral arrangement and has also entered bids on the relevant syndicate in the same auction should ensure that their compliance officer is able to respond to queries, if raised, by the regulators on the afternoon of Day Two of an auction (or during both Day One and Day Two where there has been mandatory disclosure). A failure to satisfy any queries of the regulators may result in auction bids being withdrawn.”

- (2) A new paragraph 14.10 shall be added in the following form:

“Parties to a bilateral transaction where a members' agent has been involved in arranging that transaction are required to make a disclosure to the Auction Office that the bilateral transaction will be entered in an auction by those parties and that disclosure shall include the following information –

- i. the parties to the bilateral arrangement;
- ii. the auction in which the bilateral arrangement will be entered;
- iii. the syndicate concerned;
- iv. the date and time the transaction will be submitted to the Auction Office;
- v. the amount of capacity and the price to be paid in respect of each £1 of capacity which is the subject of the arrangement; and
- vi. such other particulars as the Auction Official may require, whether generally or in relation to the particular arrangement.

The disclosure will be submitted by one of the parties to the bilateral transaction by no later than noon on the penultimate working day before the start of that auction. Failure to make such a disclosure will prevent such a transaction from being accepted by the Auction Office.”