

CAPACITY AUCTIONS AND BILATERAL ARRANGEMENTS 2020

Explanatory Guide

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Summary of Key Auction Dates in 2020

<i>Date</i>	<i>Description</i>
Wednesday 30 September	Deadline for submitting Form A – Declaration by Issuer Part I – Details of Issuer Part II – Issuers’ Auction Funding Account Details Part III – Representations and Undertakings Part IV – Authorised Persons
Wednesday 30 September	Deadline for submitting Form D – List of Connected Persons
21 October	Auction 1 (Day One)
28 October	Auction 2 (Day One)
4 November	Auction 3 (Day One)
9 November	Statements to be issued for Auctions 1-3
20 November	Debit Date for Auctions 1-3
24 November	Credit Date for Auctions 1-3

EXPLANATORY GUIDE TO CAPACITY ALLOCATION BY AUCTION AND BILATERAL ARRANGEMENTS

1. Introduction

- 1.1 This guide has been designed to assist underwriting agents and other interested parties in understanding the capacity auction process and bilateral arrangements.
- 1.2 This guide is not intended to replace the formal Auction Rules nor the formal Bilateral Arrangement Rules and should therefore only be read in conjunction with those rules. The rules take precedence in all respects over this guide and, in the case of any inconsistency, it is the rules which prevail.
- 1.3 Parties who have reached an agreement to transfer not less than £250,000 of capacity may complete that agreement provided it is registered with the Auction Office as a bilateral arrangement and mandatory interaction with the auction, described in section 14 below, takes place.
- 1.4 Auction terminology used in this guide, is as follows:

Tenderer - a member offering to dispose of capacity

Tender order - an offer to dispose of capacity

Subscriber - a person offering to acquire capacity

Subscription order - an offer to acquire capacity

Subscriber's premium - the price a subscriber is willing to pay for each £1 of capacity he offers to acquire

Floor limit - the minimum price a tenderer is prepared to accept for each £1 of capacity he offers to dispose of

Premium - the price a successful subscriber pays for each £1 of capacity

Tender premium - the price a successful tenderer receives for each £1 of capacity disposed of.

- 1.5 Bilateral terminology used in this guide, is as follows:

Nominator – the bilateral party wishing to dispose of capacity on a syndicate

Nominee – the bilateral party wishing to acquire capacity on a syndicate

Bilateral Notice – the initial notification submitted to the Auction Office detailing the proposed transaction between the bilateral parties

Unsatisfied Bids – unsuccessful auction bids that could possibly interact with bilateral arrangements

Mandatory Interaction – the process whereby certain unsatisfied auction bids interact with bilateral arrangements

Bilateral Withdrawal Form – the form submitted to the Auction Office where the interaction with unsatisfied auction bids is 15% or more of the original bilateral arrangement and either party does not wish to continue with the transaction

Bilateral Revision Form – the form submitted to the Auction Office where interaction has taken place and the parties to the bilateral arrangement wish to complete their arrangement up to, but not exceeding, the amount of capacity originally notified to the Auction Office.

- 1.6 If, having read this guide, the Auction Rules or the Bilateral Rules, agents or other Issuers have any queries on the auction or bilateral arrangement processes they should contact the Auction Office at: lloyds-auctionoffice@lloyds.com.

2. Outline of the auction

- 2.1 Lloyd's recognises that the auction process has been developed within a unique legal structure and therefore has certain limitations, some of which are identified in the Appendix. Members' agents must ensure that such limitations and potential risk factors are communicated to those intending to participate in the auction process.
- 2.2 Through the auction process participants on syndicates in 2020 may be able to realise any value attaching to the disposal of all or part of their capacity for the 2021 year of account. The auction may also enable participants to gain access to syndicates on which capacity is available. Subscribers who are successful in acquiring capacity will pay the various subscriber premiums stipulated in their subscription orders. For each syndicate the successful subscriber premiums are then added together and divided by the amount of capacity matched on the syndicate - this establishes an average tender premium which is paid to all persons who successfully tendered capacity on the syndicate.
- 2.3 The auctions to be held in 2020 deal only with the entitlement to participate on the 2021 year of account. Earlier years of account are not affected.
- 2.4 The auction process will be overseen by the Head of Legal & Compliance, Peter Spires, who is known for these purposes as the Auction Official. The Auction Official is responsible for the conduct of all auctions and the interpretation of the Auction Rules. Member Services will undertake the day-to-day administration of each auction and bilateral arrangement.

3. Participants, Issuers and qualification procedures

- 3.1 Participation as a tenderer or subscriber in the auction process is generally limited to members, candidates for membership and MAPA operators. All subscribers for capacity on a syndicate must be in compliance with requirements relating to solvency and funds at Lloyd's and must have complied with any cash calls. Candidates for membership must be able to demonstrate that they have sufficient funds available to meet the requirements set by the Council of Lloyd's to be permitted to underwrite in 2021 up to the total amount of capacity acquired in the 2020 auctions.
- 3.2 Members of syndicates for the 2020 year of account may offer to dispose of their capacity irrespective of their compliance with solvency and other requirements.
- 3.3 If a member dies during 2020, his capacity, including any acquired in 2020 prior to his demise, may be offered for disposal by any members' agent acting on behalf of his estate. See section 15 below for the arrangements for Names who die during the last few months of the year.
- 3.4 Issuers are the only persons permitted to submit orders on behalf of participants in an auction. The following may register as Issuers:
 - ◆ members' agents;
 - ◆ certain corporate members and corporate candidates;
 - ◆ managing agents.

NB Those wishing to act as Issuers in 2020 must register by completing Form A which is set out at the end of the Auction Rules. This must be returned to the Auction Office by Wednesday 30 September 2020.

3.5 Capacity to be acquired pursuant to subscription orders issued on behalf of candidate corporate members, taken on its own or with other capacity already acquired in an auction earlier in 2020, cannot exceed three percent of the latest estimated syndicate stamp figure for 2021 unless the relevant managing agent gives its prior consent by signing and submitting Part I of Form C to the Auction Office.

4. Submission of orders

4.1 Orders to subscribe for or tender capacity will only be accepted electronically in the required form.

4.2 A subscription order must specify the amount which the subscriber is willing to pay in respect of each £1 of subscribed capacity (i.e. the subscriber premium), and whether the order should roll forward if unsatisfied either in whole or part.

4.3 A tender order must specify the minimum premium which the tenderer is willing to receive in respect of each £1 of tendered capacity (i.e. the floor limit), and whether the order should roll forward if unsatisfied either in whole or part.

4.4 An application will be available free of charge to all Issuers to enable the submission of orders electronically to the Auction Office.

Key points are as follows:

- ◆ each order must relate to a single subscriber or tenderer and syndicate;
- ◆ each subscription/tender order must be in the Lloyd's required format;
- ◆ orders may only specify capacity in multiples of £1; and
- ◆ the subscriber's premium and floor limit must be in multiples of 0.01p per £1 of capacity subject to a minimum subscribers' premium and floor limit of 0.10p.

4.5 The auction office will be open for the purpose of submission of orders from 9am to 2pm on Day One and from 9am to 2pm on Day Two of the auction. The validation of files will be acknowledged via email.

4.6 Prior to the first auction a list of all the confirmed pre- and de-emptions will be published by the Auction Office via the Auction Newsletter. The relevant capacity to be entered in the orders for each of the auctions will be the underwriting capacity for the 2021 year of account i.e. the 2021 underwriting capacity after making any adjustment for pre-emption or de-emption (thus a £10,000 2020 participation with a 10% confirmed pre-emption for 2021 should be entered as £11,000 in the auction).

4.7 An order that has been submitted can be revised by a revision notice following the procedure outlined in 4.5 above. However, the revision notice can only be used to "improve" a previous order (i.e. to specify a higher subscriber's premium for a subscription order or a lower floor limit for a tender order). A revision notice cancels the existing order and creates a new order. The priority of the original order will be lost (see 5.2 below).

4.8 When submitting a tender or subscription order, Issuers will have the option of

allowing wholly or partially unsuccessful orders to roll over automatically to the next auction (up to and including Auction 3), to the extent they remain unsatisfied after any mandatory interaction with any proposed bilateral arrangement - see 14 below. Unless the option to roll over is chosen, and assuming no interaction with a proposed bilateral arrangement, unmatched orders will have to be re-submitted into another auction.

- 4.9 To withdraw an order that has been marked to roll over from a previous auction, a withdrawal notice should be submitted by 2pm on Day One of an auction (again, following the procedure outlined in 4.5 above)
- 4.10 "Trading" in capacity is not permitted. Generally, persons may not, therefore, acquire or dispose of capacity in one auction and then attempt to reverse the transaction, in whole or in part, in a subsequent auction. There are, however, limited exceptions to this, for example, in the case of mandatory offers, where someone has died and in certain other circumstances where the Auction Official has given permission. When deciding whether or not something will amount to "trading", account will be taken of capacity acquired or disposed of through bilateral arrangements. However, no account will be taken, when considering a member's bespoke transactions, of any transactions effected by a MAPA in which the member participates.
- 4.11 If an error occurs the Issuer should contact the Auction Office to seek consent for the mistake to be rectified through the auction - see section 12 below.

5. The capacity allocation process

- 5.1 The allocation process matches the maximum number of transactions provided that successful subscribers do not pay more than the subscription premium they stated and that successful tenderers receive at least the floor limit they specified.
- 5.2 Fundamentals underlying the process are as follows:
- ◆ in respect of subscription orders, the subscription order specifying the highest subscriber premium will be satisfied first;
 - ◆ in respect of tender orders, the tender order specifying the lowest floor limit will be satisfied first;
 - ◆ subscription orders offering to pay the same subscriber premium are then, between themselves, ranked by time of receipt with the order having the earliest time of receipt being ranked first;
 - ◆ tender orders offering to receive the same floor limit are then, between themselves, ranked by time of receipt with the order having the earliest time of receipt being ranked first;
 - ◆ the time of receipt of revision orders, rather than the time of the original order, will be relevant for the matching process;
 - ◆ successful subscribers will pay the subscriber premium inserted in their order; and
 - ◆ successful tenderers will receive the average tender premium per £ of capacity matched – to calculate the average tender premium, the proceeds paid by the successful subscribers are added together and divided by the amount of capacity matched on the syndicate.

- 5.3 The auction process provides for the maximum amount of capacity to be matched on each syndicate and tenderers all receive the same tender premium. Subscribers should note that the premium they pay for capacity could be higher or lower than the tender premium received by members disposing of capacity.
- 5.4 Issuers need to consider carefully the floor price they place on tender orders. Factors to be taken into account include:
- ◆ A bid with a lower floor price will be ranked before one with a higher floor price, i.e. it will rank earlier in the matching process.
 - ◆ If a tender is not matched in the auction it may, depending on its floor price, interact with a bilateral transaction in which case the amount receivable by the tenderer will be determined by the price of the bilateral arrangement, not the auction. However, the price will not be lower than the floor limit stipulated by the tenderer.
 - ◆ If a capacity offer has been made, the auction price may be lower than the price of the offer. Auction subscribers may include the maker of the offer since, in normal circumstances, the offeror is permitted to enter the auction and acquire capacity at a price equal to or below the offer price.

6. MAPAs

Leaving a MAPA to underwrite on a bespoke basis

- 6.1 A member of a MAPA who wishes to leave the MAPA to underwrite on a bespoke basis the following year should do so by informing the MAPA operator as early in the year as possible. After the start of the auctions, the MAPA operator may start to make adjustments to the MAPA portfolio through the auction process which may reduce the capacity that the member can take with him. Having left the MAPA, the member may choose to retain some or all of his former capacity on a bespoke basis or instruct his members' agent to tender or subscribe for capacity through the auctions.

Leaving or decreasing a share of a MAPA

- 6.2 A member of a MAPA who wishes to leave a MAPA and cease underwriting or reduce his MAPA commitment may derive value for his MAPA capacity by authorising the MAPA operator to tender the underlying capacity through the auction process. However, if the member is continuing to underwrite on a bespoke basis he may wish to retain certain of his MAPA capacity.

Joining or increasing a share of a MAPA

- 6.3 In respect of a member wishing to join a MAPA, the MAPA operator can accept the member's existing capacity or acquire capacity in the auction on behalf of the member (or a combination of both) and then admit the member to the MAPA with that capacity. The MAPA operator must satisfy himself that the interests of other members of the MAPA are not prejudiced. Similar considerations will apply to a member increasing his participation in a MAPA.

Adjustment of MAPA Portfolio

- 6.3 Subject to the restrictions set out in 7.4 below, a MAPA operator may participate in the auction on behalf of its MAPA members. Funding for the difference, if any, between the value of capacity to be acquired and the value of any capacity disposed of will however need to have been agreed with the MAPA members.

7. Position of members' agents

- 7.1 With effect from midnight on 30 November 2001, the activities of members' agents, when advising their members to become or continue or cease to be a member of a particular Lloyd's syndicate, came within the regulated activities under the Financial Services and Markets Act 2000.
- 7.2 Agents must observe their obligations to achieve the best result for each member both when advising members, administering their MAPA's and also when tendering or subscribing for capacity.
- 7.3 If a members' agent participates in an auction on behalf of a bespoke member, specific authority for all transactions must have been obtained from the member concerned. This authority must include the instructions/authorisations contained in Form B.
- 7.4 The rules only allow a MAPA operator to participate in an auction on behalf of his MAPA members if he does not incur a net expenditure or has the agreement of the MAPA members to incur a net expenditure. Form E suggests some matters which a MAPA operator may wish to include in such an agreement.
- 7.5 A members' agent must assure itself at all times that a participant in the auction is able to meet all obligations arising from the process. A members' agent will be responsible for all amounts payable by the participants for whom it acts in respect of auction fees and payments for capacity acquired.
- 7.6 Members' agents proposing to submit orders must ensure that they have taken proper account of the information available in the market.
- 7.7 Members' agents should be alert to "trading" as this is not permitted (see 4.10 above). Where a member underwrites through two or more members' agents, each agent should make enquiries of the other if the member asks them to act in an auction in respect of a syndicate normally underwritten through the other agent. Special care is needed when a member changes members' agent.
- 7.8 A members' agent must ensure that any fee it proposes to charge its members for the execution of orders on their behalf is reasonable and does not discriminate unfairly between categories of member. Agents will need to take advice on their ability to recover any proposed fees under their agency agreements and should, prior to the first auction, inform all their members of any fees that will be charged.

8. Position of managing agents

- 8.1 With effect from midnight on 30 November 2001, the activities of managing agents in relation to the auctions came within the regulated activities under the Financial Services and Markets Act 2000.
- 8.2 Under Lloyd's existing requirements, managing agents are required to submit syndicate information to supporting members' agents and direct corporate members,

usually in the form of business forecasts and plans, so they may make decisions about participating in the syndicate for the next year. Nothing in the auction process alters this position nor will managing agents be obliged to disseminate syndicate business forecasts to a wider audience.

9. Market conduct and disclosure of Relevant Information

Relevant Information

- 9.1 Anyone in possession of Relevant Information, which has not been made publicly available, in respect of a particular syndicate is prohibited from participating in an auction, or from entering into a bilateral arrangement, in respect of that syndicate. An Issuer in this position is unable to act as an Issuer for anybody in respect of capacity on the relevant syndicate.
- 9.2 Relevant Information for auction purposes is defined in Auction Rule 20(9) as being, in relation to a syndicate, information which could reasonably be expected to influence the decision of any person whether to become or remain a member of that syndicate, or to increase or reduce his participation in that syndicate. That rule also lists some specific examples of such information. Issuers and auction participants need to make a judgement in each case whether particular information is Relevant Information.
- 9.3 Information that relates to a party entering into, or considering entering into, a bilateral arrangement and any information about the details of a proposed bilateral arrangement shall not in itself be considered to be relevant information. This section 9 does not affect or limit the obligation on Issuers to disclose Relevant Information in accordance with Rule 20(4) of the Auction Rules.
- 9.4 In the context of capacity offers, those involved in any negotiations which are not public knowledge will be in possession of Relevant Information.
- 9.5 Auction Rule 20(4) imposes an obligation on managing agents to disclose Relevant Information promptly to the members of their syndicate. In addition an electronic version of the disclosure must be sent to the Auction Office via email, to the following mailbox: -
- lloyds-auctionoffice@lloyds.com
- The Auction Office will arrange for all disclosures to be posted to lloyds.com within three hours of receipt. Disclosures will be posted in their original form (i.e. unedited by the Auction Office).
- 9.6 Auction News, the newsletter published during the auction season, is designed to draw the market's attention to disclosures and announcements that are made during that period (see 9.5 and 10.1). Auction News is an appropriate medium for disclosing some Relevant Information. However Auction News should not normally be used on its own as a substitute for other more 'traditional' methods e.g. direct notification to members' agents or press releases.
- 9.7 The Auction Office will accept disclosures up to noon on the penultimate working day before an auction starts. For example, if an auction is due to commence on a Wednesday, the Auction Office will accept disclosures up to noon on the preceding Monday. If, however, a disclosure is to be listed in a regular Monday Newsletter, then the Auction Office needs to be in receipt of the disclosure by 5pm on the Friday of the week preceding an auction.

- 9.8 The ability to leave a bid to roll forward into the next auction is an administrative convenience. When an Issuer considers the bids to be entered into a particular auction, any bids that have rolled forward should be considered too and the decision taken whether they should, in effect, be re-entered into the auction. If possession of Relevant Information would preclude the submission of a fresh bid then any bids that have rolled forward from previous auctions must be withdrawn.

Market conduct

- 9.9 Issuers and auction participants must, amongst other things, not make, and must ensure that persons who are connected with them, as defined in the Auction Rules, do not make, any statement which it or they know to be misleading or engage in any conduct which creates a false or misleading impression as to the market in or value of a syndicate, in either case with a view to any person subscribing for or tendering capacity or refraining from doing so.
- 9.10 Participation in an auction by directors or staff (or in either case, their spouses) of a members' agent, or a managing agent or by a Lloyd's Council, or The Board member, or a member of the Council's or The Board's committees, is permitted. Council, Board and relevant committee members and their "connected persons" (as defined in the guidance notes that accompany their Declaration of Interests) should notify the Secretary of the Council of any proposed order in the auctions before making the order. For this purpose they are designated a 'connected person'. Disclosure of all successful orders made by such persons will be made immediately following each auction. This will be in the form of a report listing the connected person, syndicate tendered or subscribed, amount of capacity and code indicating the category of connected person.
- 9.11 Each Issuer must return to the Auction Office by Wednesday 30 September 2020 a Form D, reporting all persons or entities on whose behalf they act in 2020 and with whom they are "connected". Please note that the definition of "connected" was extended in 2000 to include NameCos and SLPs and was extended in 2006 to include LLPs. Further Forms D must be completed and returned to the Auction Office in respect of any persons with whom they subsequently become "connected".
- 9.12 All persons "connected" with a managing agent must obtain prior clearance, from the compliance officer of the managing agent to which he is connected, before any order is submitted on any syndicate of which that managing agent is the managing agent. The compliance officer must not give clearance where he has reason to believe that that person or the managing agent has Relevant Information that has not been made publicly available. The compliance officer must maintain a list of all applications for clearance submitted to him. The list may be requested by the regulators at any time.
- 9.13 Disclosures need only be made in respect of bespoke participations. MAPA participations are exempt.

10. Publication of information during the auction season

Auction News

- 10.1 Auction News is produced by the Auction Office on Mondays throughout the auction season and is the key form of communication between the Auction Office and Issuers. Additional ad hoc issues of the newsletter will be produced should the need arise. It is sent to all Issuers via email but is also available to other auction participants on lloyds.com.

Examples of the type of information that might be included in the newsletter are:-

- ◆ practical guidance from the Auction Office on auction procedures
- ◆ links to disclosure items required under Rule 20 "Relevant Information" (see 9.5 above)
- ◆ notice of anticipated pre-/de-emptions.

The newsletter highlights "Relevant Information" that has been posted on lloyds.com but publication of information in this form does not replace the obligation placed on managing agents by rule 20(4) to advise members of their own syndicate promptly of any Relevant Information.

Reports to Issuers

10.2 As described in 4.4 above, Issuers must submit orders to the Auction Office electronically. Upon successful validation of each order file, the Auction Office will publish to the relevant Issuer details of the bids that have been entered into the relevant auction. Once each auction has concluded, including any interaction with proposed bilateral arrangements, the Auction Office will make available two reports to each Issuer. The first report, the Full Results data file, will contain details of all successful bids submitted in the auction by the relevant Issuer. This will include the following:

- Bid reference
- Type of bid (subscription, tender, revision)
- Syndicate, capacity, price
- Member/MAPA
- Allocation
- Value
- Fee
- Amount due to/from Issuer

The second report will detail for each Issuer (if relevant) a Rollover Bids data file which will detail any bids wholly or partially unsuccessful in the current auction that are marked to rollover to a subsequent auction.

General information

10.3 In order to provide the market with information about the volume and price levels of both subscription and tender orders, the Auction Office will publish in respect of each day a summary schedule of all orders submitted - the "penny bands" report. The Day One report will be made available to all Issuers by 8am on Day Two of an auction. The Day Two report will be made available, together with the summary results and details of unmatched bids reports by 9am on the working day following Day Two of an auction. These reports will also be made available for members on lloyds.com as soon as is practicable.

10.4 Information on successful subscriptions and tenders will be provided electronically after each auction. The reports will be published by 9am on the working day following Day Two of each auction and include:-

- ◆ a summary for all syndicates confirming the volume of capacity matched, the relevant tender premium for each syndicate and the average weighted price

achieved for all capacity transferred in that auction;

- ◆ a “connected” persons report which gives the details of all successful orders made by “connected” persons;
- ◆ a stakebuilders’ report showing the percentage of capacity a member and any connected persons hold on a syndicate if it is above 25%;
- ◆ the £100k plus report showing the members who have been involved in the successful transfer of £100,000 or more of capacity on a particular syndicate; and
- ◆ an “all results” report, if pre-ordered, will be made available to the requesting Issuer.

10.5 The auction site at <http://www.lloyds.com/Capacity> will carry the following:

- ◆ by 8am on Day Two of each auction, the “penny bands” and “current prices summary” reports
- ◆ by 9am on the working day following Day Two of each auction, the “penny bands”, auction summary and unmatched bids reports
- ◆ on successful completion of the auction, the first four reports referred to in 10.4
- ◆ editions of Auction News

11. Fees and settlement

11.1 Fees will be levied as follows:

- | | |
|----------------------------------|---------------------------|
| ◆ Successful subscription orders | 0.06% of capacity matched |
| ◆ Successful tender orders | 0.06% of capacity matched |

11.2 The statement and settlement days are set out in the summary of auction dates. On the statement day the Auction Office will provide each Issuer with a detailed statement setting out the net amount payable or receivable in respect of the orders submitted. The statement will contain the order numbers, the syndicate numbers and the capacity allocated, the premiums or tender premiums payable/receivable and the Lloyd's fees. If the net amount is a deficit the Issuer will also be sent an invoice.

11.3 Settlement of amounts due in respect of fees and premiums payable/receivable will be the sole responsibility of the Issuer. Each Issuer will therefore need to ensure that it has the necessary systems in place to record which members have placed orders and the relevant details of those orders. Similarly, Issuers will need to develop their own systems for collecting monies required to cover fees and premiums payable. Monies must be held in a client account dedicated to holding auction monies. The distribution and collection of monies for this purpose should be reviewed by the Issuer's auditors.

- 11.4 If amounts due to Lloyd's are not fully paid by the due date, payment to Issuers who are owed monies will be reduced pro rata. Names of defaulters will be published. The defaulters will be pursued (and liable to pay interest at 3% above the base rate of National Westminster Bank plc) and a further settlement in respect of monies subsequently collected will follow. Any delay in payment by an Issuer could result in a delay in settlement to all Issuers.
- 11.5 If an Issuer fails to settle he will not be permitted to enter any further orders until he has made due payment in respect of previous auctions.
- 11.6 Issuers are reminded that, broadly, all monies payable or becoming payable to a participant are assets of the premiums trust fund. As such, they can only be released to a member in accordance with the release mechanisms in the premiums trust deed. For practical purposes therefore a member will only be entitled to receive his auction proceeds if he has assets at Lloyd's sufficient in value under the PTD release of funds requirements to enable the auction proceeds to be released to him. The rules for MAPA auction proceeds are slightly different in that, broadly, amounts due to a member in respect of the sale of capacity within that MAPA can be released for the acquisition of other capacity within the same MAPA.

12. Rectification of errors

- 12.1 The Auction Official has the power to agree that certain administrative errors may be corrected through the auction, by, in appropriate circumstances, permitting an order to be entered to deal with capacity transferred or acquired as a result of an Issuer's error. Issuers may request the Auction Official to exercise this power by submitting a written request.

13. Taxation

13.1 *Capital Gains Tax*

Individual Members

Syndicate capacity in the hands of individual members or individual partners in Scottish limited partnerships or limited liability partnerships is a chargeable asset for capital gains tax purposes. Accordingly, any disposal of capacity at auction or under a bilateral arrangement is a chargeable disposal for capital gains tax purposes and may result in a capital gain or a capital loss arising. Where the relevant conditions are satisfied, business taper relief and CGT rollover relief will be available to reduce or defer any capital gains tax charge arising on the disposal of capacity.

Corporate Members

Syndicate capacity in the hands of corporate members comes within the intellectual property tax regime in Schedule 29 of Finance Act 2002. Accordingly, any disposal of capacity will give rise to a trading receipt or deduction. In broad terms, the profit or loss to be brought into account for tax will generally be the proceeds of the sale less the cost of the capacity, as reduced by any tax deductions previously given. If the proceeds are reinvested in a qualifying asset under the new intellectual property tax regime the taxable amount may be rolled into the new asset providing certain conditions are met, so deferring the taxable receipt that would otherwise arise.

Value Added Tax

- 13.2 Customs and Excise have advised us that payments made for capacity allocated under the auction process will be exempt from VAT. Fees charged by Lloyd's in

connection with the auction process are also exempt but any services provided by members' agents are standard rated at 20% (or the prevailing standard rate at the relevant time).

14. Bilateral arrangements

- 14.1 Subject to certain conditions, a bilateral arrangement which involves the transfer of not less than £250,000 of capacity on a syndicate is allowed. For this purpose the parties to the arrangement are the person making the participation nomination ("the nominator") and the person in whose favour the participation nomination is being made ("the nominee"). The price agreed to be paid for each £ of capacity is the "bilateral price".

Interaction

- 14.2 Bilateral arrangements are subject to a mandatory form of interaction with the auctions to ensure that certain unsatisfied subscription orders and tender orders are satisfied in priority to the proposed bilateral arrangement. Interaction with the auction involves: -
- ◆ the nominee acquiring capacity (up to the amount of the proposed bilateral arrangement) specified in tender orders which were (partly or wholly) unsatisfied in the auction where the floor limit specified in those orders was below the bilateral price - the nominee will pay the relevant tenderers the bilateral price; and
 - ◆ the nominator "transferring" capacity (up to the amount of the proposed bilateral arrangement) to satisfy subscription orders which were partly or wholly unsatisfied in the auction where the subscriber's premium specified in those orders was higher than the bilateral price - the auction subscribers will pay the subscription premiums stipulated in their orders.
- 14.3 The requirement for interaction with the auction seeks to ensure that those tenderers whose orders have not been satisfied in the auction and who were willing to transfer their capacity for less than the bilateral price may achieve their objective. Equally subscribers whose subscription orders were unsatisfied in the auction and who were willing to pay a higher price than the bilateral price may achieve their objective.

Timetable

- 14.4 Proposed bilateral arrangements must be notified to the Auction Office before 2pm on Day Two of an auction. Appropriately authorised representatives of the bilateral parties must make themselves available, by providing direct phone and e-mail addresses at their own offices, between 2pm and 4.30pm on Day Two to receive the relevant reports and complete any necessary documentation. On completion of the auction, the Auction Office will prepare a report showing unsatisfied subscription orders and tender orders to enable those who have registered a bilateral arrangement to assess the maximum interaction to which they might be subject.
- 14.5 If the amount of the potential interaction is greater than 15% of the capacity that is the subject of the proposed bilateral arrangement, the participants to the bilateral arrangement may choose to withdraw the entire arrangement. Notice of withdrawal must be given by 4.35pm on Day Two.

- 14.6 If the parties do not withdraw, they will be advised of the actual extent of the interaction in relation to their arrangement. If there has been no interaction, the arrangement will be validated by the Auction Office. If there has been interaction, the parties will have until 4.45pm on Day Two to submit a revision notice, otherwise the capacity covered by their arrangement will be reduced to take account of the interaction.
- 14.7 By 9am on the working day after Day Two of an auction the Auction Office will publish results of the auction, the interaction and details of completed bilateral arrangement transactions

Size and frequency of transaction

- 14.8 Bilateral arrangements must be for at least £250,000 of capacity. However, smaller holdings of capacity on the same syndicate can be aggregated for the purposes of meeting the £250,000 minimum limit provided the members have a common members' agent. Managing agents are not permitted to take part in or promote such aggregation arrangements. Parties are restricted to a maximum of twenty-five bilateral arrangements per syndicate in any one year of account, whether as nominator or as nominee.

Disclosure

- 14.9 Information that relates to a party entering into, or considering entering into, a bilateral arrangement and any information about the details of a proposed bilateral arrangement shall not in itself be considered to be Relevant Information. However, this does not affect or limit the obligation on Issuers to disclose Relevant Information in accordance with Rule 20(4) of the Auction Rules (see paragraph 9 of this Guide for further information).

Priority and Matching

- 14.10 The matching system generally mirrors that of the auction, but additionally:
- ◆ Bilateral arrangements will interact with unsatisfied subscription orders and tender orders in descending price order (i.e. the bilateral arrangement with the highest bilateral price will interact first).
 - ◆ Where two bilateral arrangements are submitted at the same price, the obligation to interact will be apportioned on a pro rata basis.
 - ◆ The auction participants whose tenders are matched in this way will be paid an average price produced by pooling the bilateral prices and dividing them pro rata among the matched auction tenders. The resultant average price will be published.
 - ◆ Where a nominator satisfies unsatisfied subscription orders, there will be no averaging of price. Each subscriber will pay the subscriber's premium stipulated in their original order and the proceeds will accrue to the nominator with whom they are matched.
- 14.11 When the Auction Office publishes all the information about auction activity at the end of an auction there may be several different prices disclosed for any syndicate. These may include the tender price resulting from the auction, the average price paid

to auction tenderers interacting with any bilaterals and the prices at which any bilateral arrangements have taken place.

Forms and Administration

14.12 At an early stage parties considering entering a bilateral arrangement should identify a contact who will act for both parties. The contact, who will be identified on the initial notice, must establish certain essential communication links. In practice any Issuer will have the necessary links in place to send and receive messages and deal with any transfers of funds necessitated by interaction with the auction. The contact will need to have arranged with the Auction Office: -

- (i) to receive reports by email;
- (ii) the bank account that should receive any payments that may become due to the nominator from the Auction Settlement Account.

14.13 A bilateral notice describing the proposed bilateral arrangement should be submitted to the Auction Office before 2pm on Day Two of an auction. This must take the form of a completed Form BN (if the nominator or the nominee is more than one person, a schedule must be attached giving details (see forms BN/BSG and BN/BTG)). The form must be e-mailed to the Auction Office at lloyds-auctionoffice@lloyds.com and the Auction Office will confirm receipt. A further confirmation will be sent to the contact once the form has been checked.

14.14 When e-mailing bilateral forms to the Auction Office, the contact should insert a reference at the top of every submission as follows: -

BN/(Issuer ID)/(Serial No) e.g. **BN9999/01**

This reference will identify uniquely each particular bilateral arrangement. Contacts should ensure that the reference is included on all relevant forms i.e. Bilateral Notice (BN), Bilateral Withdrawal (BW) and Bilateral Revision (BR).

14.15 Parties to a bilateral arrangement need to ensure that they have suitably authorised representatives available (via telephone) to speak to, and complete and return relevant documentation to, the Auction Office between 2pm and 4.30pm on Day Two of the auction. The report showing the level of "unsatisfied" bids will enable the parties to assess whether the level of interaction with their bilateral arrangement might be greater than 15%. If the report shows a possible level of interaction greater than 15% the parties have the option to withdraw the bilateral arrangement.

14.16 If either party to the bilateral decides that, in view of the potential interaction being greater than 15% they wish to withdraw, a withdrawal notice, Form BW, must be submitted to the Auction Office by 4.35pm on Day Two. The signature of only one of the parties is necessary on this form

14.17 The Auction Office will then run the interaction with the auction and will advise the representatives of the extent of interaction, if any, between the unsatisfied auction bids and the bilateral arrangement.

14.18 The representatives will then need to decide whether they are content for the bilateral arrangement to be reduced by the amount of the interaction. If the parties take no further action the reduced bilateral arrangement will be validated by the Auction Office. In addition to their interaction obligations the bilateral parties may elect to complete their original arrangement up to, but not exceeding, the amount of capacity originally notified to the Auction Office. The intention to proceed on this basis must be notified to the Auction Office by 4.45pm on Day Two of the auction. A Bilateral

Revision form, (Form BR), which needs to be signed by both parties, must be used

14.19 If the bilateral has interacted with the auction so that tenders from the auction have been satisfied, the nominee under the bilateral arrangement will receive an invoice and must provide the necessary funds by the relevant auction settlement date. Any subscription premiums due to the nominator from auction participants will be paid into the account identified by the contact.

14.20 The fees for bilateral arrangements are as follows: -

◆	Successful bilateral arrangement (payable by both parties)	0.06 % of capacity matched
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14.21 As has been mentioned in 4.10 “trading” in capacity is not permitted and this includes “trading” through bilateral arrangements.

14.22 Where one or more of the parties to the bilateral arrangement is resident outside the United Kingdom the parties should be aware of certain issues which may be relevant to them. Appendix 3 to the regulatory bulletin issued in May 1998 entitled “Review of Capital Rules – Bilateral Arrangements” contains a summary of certain of these – it is not intended to summarise comprehensively the position in the relevant jurisdiction or to constitute definitive legal advice as it is the primary responsibility of the bilateral parties and their advisers to ensure compliance with overseas securities laws and all other relevant legislation in the jurisdiction(s) concerned. Therefore, Lloyd’s accepts no responsibility or liability in this regard.

15 Transfers of capacity after the Third Auction

15.1 In September 2000, Council approved certain arrangements for transferring capacity for value where the capacity had been released by the death of a member too late in the year for it to be tendered in any auction. Under these arrangements, if a member dies so late in the year that it is impracticable for his agent to tender the capacity in an auction, the capacity can be transferred on behalf of the estate to another member or members who have the necessary FAL in place, provided the transfers are notified to the Auction Office before the following 1 January.

15.2 Further details of these arrangements, together with details of the notification required when a transfer of capacity under them has been successfully affected, are set out in Regulatory Bulletin 070/2000, issued on 14 September 2000. Transfers made under these arrangements will not require the consent of the managing agents of the relevant syndicates.

15.3 Members’ agents and members participating in these arrangements should be aware that the restrictions on trading described in paragraph 4.10 above apply to these arrangements.

LIMITATIONS TO THE AUCTION PROCESS

Lloyd's recognises that the auction process has been developed within a unique legal structure and therefore has certain limitations. Some of these are identified below:

- There is a season consisting of three auctions to be held in October/November.
- The value realised when surrendering capacity may not reflect the capacity's "true" value since the value realised depends on supply and demand in a particular auction. Values may therefore vary substantially between auctions.
- There are now a number of ways, in addition to the auctions, in which participants may be able to achieve value for their capacity, i.e. conversion schemes, capacity offers and bilateral arrangements. Each of these may result in a different value being attributed to the capacity.
- The value of the capacity might be higher, lower or non-existent next year.
- The benefit being acquired is the right to underwrite on a given syndicate for the 2021 year of account. Managing agents will have produced business forecasts before the start of the auctions but many changes could take place in the intervening months before the start of the following year of account. For example, the underwriter could become incapacitated or leave, the syndicate might have to cease underwriting or a merger might become essential, the control of the managing agency could change or the underwriter might decide on a radical change of approach. In practice, all these events would probably result in the managing agent offering to release a member from his obligation to underwrite on the syndicate for the following year but the member would not be able to recover any subscription premium he has paid or agreed to pay.
- "Trading" in capacity is not generally allowed, so the auction differs from other markets.
- Capacity transactions once effected cannot be reversed.
- The information provided is not sufficient to make the auction completely transparent. On Day Two of the auction all orders are entered on the basis of the same information about Day One but the activity on Day Two is not published until after the end of the auction.
- Orders that are not satisfied in an auction may be satisfied by interaction with a proposed bilateral arrangement. Where there is interaction, the result for a subscriber will be as if the order had been successful in the auction. Tenderers however will receive an average of the bilateral prices on the syndicate. This will be at, or above, the floor price stipulated in their order but could be below the average tender price achieved in the auction.