

**FROM:** Head of Capacity Markets, Regulatory Division  
**LOCATION:** 58/SW1  
**EXTENSION:** 5897  
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**SUBJECT:** **GUIDANCE ON MINORITY BUY-OUTS**

**ATTACHMENTS:** None  
**ACTION POINTS:** For information  
**DEADLINE:** None

## **1 Summary**

- 1.1 This bulletin contains guidance on how the Council might in future be expected to exercise its discretion under the Major Syndicate Transactions Byelaw (the Byelaw) when considering whether to grant permission for a minority buy-out.
- 1.2 This guidance was requested in September 1999 by Lloyd's Regulatory Board and its publication was therefore identified in Lloyd's Regulatory Plan for 2000 as an objective of the Capacity Markets team.
- 1.3 This guidance is neither rules nor regulation, nor does it fetter in any way the future exercise of the Council's discretion under the buy-out rules. It is being published to improve the understanding of how the minority buy-out rules might be applied in practice and to assist market participants and their advisers in working with the Regulatory Division. The guidance should be read in conjunction with the minority buy-out rules set out in paragraph 2 of (and Schedule 2 to) the Byelaw.

## **2 Background**

- 2.1 An application for permission to effect a minority buy-out must be preceded by a capacity offer made by a managing agent or any connected company which is an underwriting member or candidate for membership. The application must be made by a managing agent and the connected company making the capacity offer and can only be proceeded with if that capacity offer has been accepted by members of the syndicate whose capacity, taken together with the capacity held by any connected company of the managing agent, for the then current year of account is not less than 90% (or such other proportion as the Council may specify, either generally or in relation to a particular case) of the syndicate's overall capacity for that year of account.
- 2.2 In considering whether to grant permission, the Council will take into account the level of support of members of the syndicate for the offer and, in particular, whether the 90% level referred to in 2.1 has been met. The Council may also take into account:
- the reasons why the minority buy-out is proposed;
  - the adequacy of the consideration offered to members; and
  - any other matter which, in the opinion of Council, should be taken into account.

Thus, the Council retains a discretion in all cases to grant or refuse permission for a minority buy-out. The attainment of the 90% threshold (which itself can be raised or lowered at the discretion of the Council) is a necessary, but not in itself sufficient, condition to obtaining this permission.

- 2.3 The minority buy-out rules were introduced in 1997, although nobody applied for permission to do a buy-out in that year. During 1998, application was made and consent given in respect of two buy-outs. In 1999, nine buy-out applications were received, of which eight were approved. The guidance that follows is based largely on the Regulatory Division's experience of processing those buy-out applications.

## **3 Guidance**

- 3.1 There is no discretion to dispense with the requirement to make, and secure some level of acceptance of, an offer before applying for permission for a minority buy-out. However, as was stated in 2.2 above, the Council may set a threshold above or below 90%, either generally or in a particular case.
- 3.2 As required by the Byelaw, capacity held in territories such as Singapore (i.e. a territory into which an offer cannot legally be made) or capacity already acquired in the year by the offeror or its connected companies will be disregarded and the syndicate's overall capacity for the current year of account, by reference to which the 90% threshold is calculated, will be reduced accordingly.

- 3.3 The Byelaw does not specify a minimum level of acceptance of an offer preceding a buy-out application. It simply requires that acceptances of that offer, taken together with capacity already held by the managing agent and its connected companies, account for 90% or more of the syndicate's aggregate capacity. As was stated in 3.1 above, there must, therefore, be some level of acceptance of the offer before permission for a buy-out can be sought. In theory, that level could be minimal if the offeror and its associates held nearly or more than 90% before the offer was made. In practice, the approach adopted in 1999 by the Regulatory Division was to require that, as a minimum, a natural majority (i.e. more than 50% in capacity terms) of offerees had accepted the offer. The Regulatory Division intends to adopt a similar approach in 2000, although this approach may need to be varied where, for example, the Division is made aware that a majority in capacity terms is constituted by a small number of members or a single member, while the dissenting minority represents a larger number or wider range of members.
- 3.4 In some circumstances, auction and bilateral purchases at or below the offer price, either during the currency of the offer or immediately following its closure, may be treated as acceptances of the offer. An example might be when an offeree is unable to accept an offer while it is open but, following the offer's closure, becomes able to and does accept the offer by selling its capacity in the auction to the erstwhile offeror at the offer price. The effect will be similar, if not identical, to Council accepting, as discussed in 3.1 above, a threshold of less than 90%.
- 3.5 Where, irrespective of the overall level, acceptances of an offer are known to be composed, in whole or part, of those received from members who, whilst not connected companies of the managing agent under the Byelaw's definition, are associates in some other sense of that agent (for instance, its directors or employees), it might be inappropriate to permit members of an independent, dissenting minority to be bought out on the basis of acceptances received from parties not entirely at arms' length to the managing agent or its connected companies.
- 3.6 Regardless of the level of acceptance of the relevant offer, it is arguable that an offer price could be deemed to be inadequate consideration for a buy-out where a proposed merger of syndicates, approved by the requisite majority of members, has implicitly or explicitly attributed to the syndicate's capacity a higher value than the consideration proposed to be paid for the buy-out. The Council may, therefore, refuse to permit a buy-out to be effected on the basis of an offer price when a higher value, explicitly or otherwise, has contemporaneously been used to solicit or underpin support for a merger proposal from that syndicate's members.
- 3.7 The adequacy of the consideration for a buy-out may also be deemed inadequate where the offer preceding the buy-out application triggered a mandatory offer, but no such offer has been made. If, in such circumstances, the price offered under the offer was less than the minimum that would have to be paid under the Mandatory Offer Byelaw (that is to say, the highest price paid by the offeror and its associates in the last twelve months), it is arguable that the offer price is inadequate.
- 3.8 Furthermore, where a syndicate whose members are to be bought out is to be merged with a syndicate that will contain minority capital providers for the following year of account, permission for a buy-out may, unless the managing agent can adduce good reasons to the contrary, be refused on the basis that the advantage to the managing

agent if a buy-out is permitted is outweighed by the disadvantage to the minority thus bought out.

#### **4 Procedure**

- 4.1 A managing agent must give notice of its intention to terminate an agency agreement by effecting a minority buy-out by 30 April. The Council may then grant conditional consent to the termination of the relevant managing agent's agreements, subject to the buy-out itself receiving approval at a later date under the Byelaw.
- 4.2 The Council's discretionary powers and functions under the Byelaw in respect of minority buy-outs are exercised by the Business Conduct Committee of Lloyd's Regulatory Board (BCC). The BCC will consider representations from an applicant or any other party affected by a proposed buy-out. Anyone wishing to make such representations should contact, in the first instance, the Head of Capacity Markets or another member of that department.
- 4.3 If you have any queries about the contents of this bulletin or the operation generally of the minority buy-out rules, please contact Richard Miller (extension 5897), Andrew Thomas (extension 6225) or Irene Dick (extension 5454).
- 4.4 This bulletin has been sent to all underwriting agents, direct corporate members, market associations (including the ALM) and for information to recognised accountants.

Richard Miller  
Head of Capacity Markets  
Regulatory Division