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LOCATION: Legal Services, G5

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SUBJECT: NEW CENTRAL FUND CONTRIBUTIONS,
SYNDICATE LOANS, MEMBERS'
SUBSCRIPTIONS AND OTHER CHARGES FOR
2005

SUBJECT AREA(S):

ATTACHMENTS:

ACTION POINTS: **Notification of contributions, subscriptions, loans
and payment dates**

DEADLINE:

1 Summary

1.1 Council has now approved the New Central Fund contribution rates, the introduction of syndicate loans and members' subscriptions and entrance / application fees for 2005.

1.2 The principal central contributions, subscriptions and loans are set out below:

	2004	2005
New Central Fund contributions	1.25%	0.50%
Members' subscriptions	0.50%	0.50%
Syndicate loans to the New Central Fund		0.75%
	<u>1.75%</u>	<u>1.75%</u>
Callable New Central Fund contributions	3.00%	3.00%

1.3 The rates of contribution to the New Central Fund, including syndicate loans and the callable contribution, are consistent with the recommendations of the Capital Working Group as communicated to the market in July through the Capitalisation Update. The reduction in New Central Fund contributions together with the introduction of the syndicate loans keeps these central costs static at 1.75% for 2005. In addition the introduction of the syndicate loans provides a more efficient way for members to contribute to the New Central Fund. Consistent with the obligation to assess our capital annually the Council will have to consider the appropriate New Central Fund contribution and loan rates each year.

2 Members' Subscriptions

- 2.1 The Council agreed that the rate for all underwriting members' subscriptions for 2005 should be 0.50% of allocated overall premium limits (OPL), unchanged from 2004, payable in two instalments. The first instalment at 0.25% of allocated OPL is due on 3 January 2005 and the second instalment of 0.25% of OPL payable by 1 June 2005..The members' subscription is exempt from VAT.
- 2.2 A bulletin concerning instructions for the payment of members' subscriptions and the Franchise Performance and Risk Management charge, which is also payable in two instalments, will be issued in early December.

3 New Central Fund contributions

Annual contribution

- 3.1 The annual New Central Fund contribution rate payable by all members (other than new corporate members) for the 2004 year of account is to fall by 0.75% to 0.50% of a member's syndicate premium limit in respect of each syndicate of which he is a member.

New corporate members

- 3.2 New corporate members for 2005 will pay 2.5% for each of their first three years of operations. A new corporate member is one which joins Lloyd's in 2005 and establishes / participates 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 that 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.
- 3.3 Where a newcomer to the Lloyd's market chooses to participate by purchasing an existing corporate member that has reinsured to close all its liabilities, that corporate member will be treated as a new member and it will be required to pay the higher contribution in respect of its participations on new syndicates.
- 3.4 Within the category of new corporate members the increased charges 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 New corporate members who joined in 2004 will continue to pay double the standard rate of contribution for their second and third years of operation at Lloyd's (i.e. for 2005 this will be 1%)

Qualifying Quota Share arrangements

- 3.6 Where syndicates enter into qualifying quota share arrangements outside the Lloyd's market further New Central Fund contributions are payable. For 2005 the additional contribution rate will remain at 1.25% (the 2004 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. Charges will be made on 1 April 2006 and annually thereafter.

Callable contribution

- 3.7 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 2005 year of account.

Payment date

- 3.8 The annual New Central Fund contribution for 2005 including those payable by new corporate members is payable in one instalment due on 1 April 2005 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 New Central Fund contributions.

4. Syndicate loans

- 4.1 The syndicate loans have been introduced as a result of the work of the Capital Working Party. Following consultation, it was clear that the proposals for syndicate loans had the support of the majority of businesses in the market as they represent a more efficient means of funding the New Central Fund. The terms on which loans will be made to the New Central Fund by syndicates have been discussed with members of the Capital Working Party and the main features were described in the Capitalisation Update which was sent out to the market in July.
- 4.2 The vast majority of the terms of the loans are designed to comply with the current draft FSA capital adequacy requirements recently published by the FSA in PS 04/16 (its policy statement on the proposed Integrated Prudential Sourcebook for insurers). The FSA has not yet issued its policy statement regarding the new prudential rules for Lloyd's but we have had to assume that the FSA will wish to apply the same requirements to Lloyd's. It is possible that the terms of the loans may need to be amended prior to the Loan Requirements coming into effect on 1 January 2005 to reflect the finalisation of the FSA's Integrated Prudential Sourcebook.
- 4.3 The rate for the syndicate loans has been set at 0.75% of a member's syndicate premium limit in respect of each syndicate of which he is a member for 2005.

4.4 At its meeting on 1 September, the Council made the syndicate loan requirements (the “Loan Requirements”) set out in Appendix 2 which set out the terms on which the loans will be made. In summary the key terms are -

- ***Advance and repayment*** - loans will be made in April of the relevant year of account and repayment is at the discretion of the Council. Managing agents will have the option to make the loans in sterling or US dollars. Whilst Lloyd’s is not obliged to make a repayment (other than in the event of a winding up of the Society), in normal circumstances it is expected that there will be a rolling repayment of a proportion of the overall debt to coincide with the RITC of a year of account after the loans have been being outstanding for 3 years. Where a syndicate goes into run-off, repayment will be dealt with on a case by case basis. A repayment could be made to allow the syndicate to meet the costs of run-off, however, there may also be circumstances where Lloyd’s may not repay the loans on the expected repayment date.
- ***Interest*** - interest is payable annually but may be deferred at Lloyd’s discretion. Deferred interest shall accumulate. As the loans are syndicate assets, the interest that is paid on them will form part of the syndicate profit or loss that is apportioned to the members of the syndicate for UK corporation and income tax purposes.
- ***Interest Rate*** - interest will be paid at a rate equal to the total return recorded during the interest period by specified market indices which record the performance of short-dated fixed-interest securities. The Merrill Lynch 1-3 Year UK Government Total Return Index and the Merrill Lynch 1-3 Year US Government Total Return Index will be used to calculate interest amounts payable on loans denominated in sterling and US Dollars respectively. Interest calculated on this basis will more closely reflect the investment dispositions typically adopted by managing agents in investing syndicate assets. An amount reflecting administrative costs to the Central Fund, equal to 0.07% per annum of loan values, will be deducted from the index generated returns when calculating interest amounts payable. In the unlikely event that the calculated interest amount applicable to an interest period is negative, then the interest amount will be zero.
- ***Subordination*** – the syndicate loans are deeply subordinated and in particular it is intended that they will be subordinated in terms of principal to the bondholders of any subordinated debt issue (discussed in paragraph 4.10 of this Bulletin). With regard to interest, no payment of interest can be made in respect of the loans if the Society is not paying interest on any other borrowings of a capital nature.

Accounting treatment

4.5 We have been working with Ernst & Young and the Lloyd’s panel of auditors to ensure a consistent accounting treatment of the loans in the accounts of the syndicates and members. It is accepted that the syndicate loans are a syndicate asset and the expected treatment is to report the asset as an “other loans” within investments, in accordance with Schedule 9A.

- 4.6 Lloyd's intends to issue a quarterly certificate (the "Certificate") confirming the existence of the asset and the amount of any accrued interest and that to the best knowledge and belief of Council there are currently no reasons why the loan would not be repaid on the expected repayment date. In addition, annually, Ernst & Young, in its capacity as the Society's auditors will issue a report supporting the Certificate issued by Lloyd's and confirming that the nominal amounts have been extracted from the underlying records. The report of the auditors and the Certificate issued by Lloyd's in January each year, in advance of the finalisation of syndicate and corporate member report and accounts, would be based on the latest available unaudited figures in respect of central assets and members' solvency deficits.
- 4.7 The Certificate should normally be sufficient to confirm existence of the loan. With respect to valuation, the normal basis will be market value. Market value will take account of the default risk, the expected repayment date and the expected returns from it. The directors of each managing agent, in conjunction with their auditors, will need to form their own view of the market value of the syndicate loan. In view of the Certificate issued by Lloyd's confirming the current intention to repay the loan as expected and the interest rate payable, as detailed above in 4.4, normally we would expect any discount to par value to be negligible.

Solvency and regulatory capital treatment

- 4.8 With respect to the solvency treatment of the loan, the asset will be disallowed at member level. This is consistent with the intention to invest the proceeds of the loan in assets eligible for the Society's solvency and include them within the level of central assets available to cover the aggregate of member level solvency shortfalls.
- 4.9 With respect to the treatment of the loan asset for capital purposes, the asset will not be eligible for member level capital requirements. The asset will be included within central assets as Upper Tier 2 capital and taken into account in the assessment of the overall capital adequacy of Lloyd's and Lloyd's is working with the FSA to ensure that the level of central assets are reflected in member level capital setting.
- 4.10 The vast majority of respondents to Lloyd's consultation about the proposals for Lloyd's capital structure also supported the concept of Lloyd's raising subordinated regulatory capital in the capital markets. We continue to explore the feasibility of any such issue.

5. Financial Services Compensation Scheme

- 5.1 Lloyd's was brought within the scope of the Financial Services Compensation Scheme ("FSCS") with effect from 1 January 2004. Council has agreed that for 2005 the Central Fund should meet the first £10m of any levy charges, inclusive of any contribution to cover the operational costs of the FSCS, on the Lloyd's market in 2005 (there having been no levy charges to date for 2004). This concession, which applies principally to the personal lines underwriters, will be reviewed annually and is subject to the ongoing performance of the personal lines market.

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 2004.

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), John Parry, Extn 5129 (e-mail john.parry@lloyds.com) or Andrew Hodson, Extn 5052 (e-mail andrew.hodson@lloyds.com).

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

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APPENDIX I

2005 ENTRANCE & APPLICATION FEES

	<u>2004</u>	<u>2005</u>
Members' Entrance fees		
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
Interavailable fee	£150	£150
Change in Controller (corporate member)	£150	£150
Change in Director (corporate member)	£150	£150
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 CENTRAL FUND SYNDICATE LOAN REQUIREMENTS

The Council of Lloyd's, in exercise of its powers under paragraph 20 of the Membership Byelaw (No. 17 of 1993) and paragraphs 6 and 8 of the New Central Fund Byelaw (No. 23 of 1996) and all other powers enabling, hereby prescribes the following conditions and requirements and resolves as follows

1. Interpretation and citation

- (1) The provisions of the Schedule hereto (interpretation) shall have effect
- (2) These conditions and requirements may be cited as the New Central Fund Syndicate Loan Requirements.

2. Requirement to make New Central Fund Syndicate Loans

- (1) It shall be condition of a member's permission to underwrite insurance business for the 2005 year of account or any subsequent year of account that, for each syndicate of which he is a member for that year of account, an amount equal to 0.75% (or such other rate as the Council may prescribe) of his member's syndicate premium limit for that syndicate be lent to the Society in accordance with and on the terms specified in these conditions and requirements (an "NCF syndicate loan").
- (2) An NCF syndicate loan shall be made at the direction of the managing agent of the syndicate concerned out of the Managing Agent's Sub-Fund of the member.
- (3) Any NCF syndicate loan shall be made in full on 1 April (or such other date as the Council may specify) of the year of account for which it is required to be made.

- (4) Every NCF syndicate loan required by these conditions and requirements shall be made without set-off, counterclaim, or deduction on any account whatsoever.
- (5) The Council may from time to time specify arrangements for the making of NCF syndicate loans, including the establishment of direct debit arrangements to be entered into between managing agents, or Managing Agent's Trustees, and the Society.

3. Currency of account

- (1) The currency of account of an NCF syndicate loan shall be sterling or, if the managing agent concerned so elects, US dollars or both currencies in such proportions as the managing agent may specify.
- (2) Any NCF syndicate loan shall be made, any repayment thereof shall be made, and any interest payable thereon shall be paid, in the currency of account.
- (3) A managing agent shall, no later than fifteen business days before the date on which an NCF syndicate loan is required to be made, inform the Society –
 - (a) whether any proportion of the NCF syndicate loan is to be made in US dollars; and
 - (b) the proportion, expressed in sterling, of the NCF syndicate loan which is to be made in US dollars.
- (4) Any proportion of an NCF syndicate loan to be denominated in US dollars shall be translated by the Society into US dollars at the middle closing foreign exchange rate published in the Financial Times (or such other rate as the Council may from time to time specify) ten business days before the date on which the NCF syndicate loan is required to be made.

4. Management of New Central Fund

The proceeds of all NCF syndicate loans shall be held, managed, invested and applied as assets of the New Central Fund.

5. Interest

- (1) Interest shall be paid by the Society on any NCF syndicate loan at such rate or rates and on such dates (each an “interest payment date”) as the Council shall specify. The Council may elect in its absolute discretion to defer payment of all or any interest which the Society is required to pay on any interest payment date (including any Arrears of Interest, as defined in paragraph 5(4) below) . If the Council elects to defer the payment of interest, that interest shall be dealt with in accordance with paragraph 5(4) below. Any failure to pay interest shall not constitute a default by the Society for any purposes.
- (2) Interest shall be paid after any deduction or withholding which the Society is required to make by any applicable law.
- (3) Where the Society has at any time before the relevant interest payment date cancelled, failed to make, suspended or deferred the payment of any interest upon any obligation of the Society of a capital nature (other than an NCF syndicate loan) which falls, in accordance with terms of the obligation concerned, to be paid or credited at any time before the interest payment date and the payment so cancelled or failed to be made, or suspended or deferred remains unpaid, interest that is payable on an NCF syndicate loan shall be deferred and dealt with in accordance with sub-paragraph 5(4); and for the purpose of this sub-paragraph a payment is to be taken as failing to be paid or credited in circumstances where it would have so fallen but for any provisions relating thereto requiring or entitling the Society to cancel, suspend or defer payment.

- (4) To the extent that the Council elects that interest shall not be paid on a particular interest payment date or where interest is deferred under sub-paragraph 5(3), that interest shall, so long as it remains unpaid, constitute “Arrears of Interest”. Subject to sub-paragraph 5(1), Arrears of Interest shall be payable on the next interest payment date to the extent that the Council has not elected to pay it in whole or in part prior to that date. All Arrears of Interest in respect of a NCF syndicate loan shall become due in full on the winding up of the Society. So long as, and to the extent that, the same has not become due and payable, Arrears of Interest shall not bear interest.
- (5) All interest shall be paid out of the New Central Fund.

6. Repayment of NCF syndicate loans

- (1) The Society shall be under no obligation to repay any NCF syndicate loan at any time otherwise than in the winding-up of the Society when it shall have an unconditional obligation to repay any NCF syndicate loan (including for the avoidance of doubt any Arrears of Interest).
- (2) The Society may, in the discretion of the Council, repay the whole or any part of any NCF syndicate loan at such time or times as the Council thinks fit.
- (3) Repayments shall be made out of the New Central Fund.
- (4) The Society may repay any NCF syndicate loan in respect of a particular member, or in relation to in particular syndicate or year of account, without assuming any obligation or giving rise to any expectation that any other NCF syndicate loans will be repaid in respect of any other members or in relation to any other syndicates or years of account in any proportion or at all.
- (5) The Society shall not repay any NCF syndicate loan unless not less, than six months before doing so, it has given notice to the Financial Services Authority of its intention to do so.

- (6) In the event of the winding-up of the Society -
- (a) the obligations of the Society in respect of all NCF syndicate loans outstanding rank equally among themselves; and
 - (b) the obligations of the Society in respect of NCF syndicate loans outstanding are subordinated to –
 - (i) all other obligations of the Society except those which are expressed to rank equally with or in subordination to NCF syndicate loans; and
 - (ii) the payment of any underwriting liabilities of members (or former members of Lloyd's or the estates of deceased members of Lloyd's) for which the New Central Fund or other assets of the Society may, in the discretion of the Council, be applied under the New Central Fund Byelaw (No. 23 of 1996) or under the Central Fund Byelaw (No. 4 of 1986);

but rank in priority to the distribution of any remaining assets of the Society to members of the Society.

- (7) The Society shall be under no obligation and shall have no liability (whether actual, contingent or prospective) to repay any NCF syndicate loan to the extent to which any such obligation would cause the Society to become insolvent if that repayment were made or to the extent that the Society's liabilities exceed its assets or would do so if that repayment were made.

7. Set off

Lenders shall, to the fullest extent possible under applicable law, waive their rights to set-off amounts they owe to the Society against any amounts owed by the Society to them under the NCF syndicate loans. To the extent that, on a winding up of the Society any set-off takes place, whether by operation of law or otherwise, between: (a) any amount owed by the

Society to the lender in respect of a NCF syndicate loan, and (b) any amount owed to the Society by such lender, the lender will immediately transfer such amount which is set-off to the liquidator (or other relevant insolvency official of the Society) to be held on trust for the benefit of creditors of the Society who rank ahead of the lender.

8. Assignment

The entitlements of the lenders in respect of an NCF syndicate loan shall not be capable of assignment otherwise than –

- (a) in connection with a contract of reinsurance to close, to a reinsurer under that contract or to the Managing Agent's Trustees of that reinsurer; or
- (b) in relation to an insurance business transfer scheme, to a transferee, or to the Managing Agent's Trustees of the transferee under that scheme.

9. Governing Law

The terms of the NCF syndicate loans shall be governed by and construed in accordance with the laws of England and Wales.

10. Commencement

These conditions and requirements shall come into force on 1 January 2005.

SCHEDULE

Interpretation

1. Except where otherwise expressly provided in these conditions or requirements, or where the context otherwise requires, words and expressions used in these conditions and requirements which are defined in the Definitions Byelaw (No. 3 of 2004) have the meanings there given.

2. In these conditions and requirements –

“Arrears of Interest” has the meaning given in paragraph 5(4);

“interest payment date” has the meaning given in paragraph 5(1);

“Managing Agent’s Sub-Fund” and “Managing Agent’s Trustees” in relation to a member and the managing agent of a particular syndicate, have the meaning given in the member’s premiums trust deed;

“NCF syndicate loan” has the meaning given in paragraph 2(1).