2007 AUCTION REPORT

AUCTION THREE 25th/26th SEPTEMBER 2007

In This Issue

Highlights

- **Capacity prices drop 20% from Auction Two levels**
- **Many sellers' expectations not met**

Auction Three – An overview

Auction Three was the largest of the three held so far this year, marginally ahead of Auction Two. More than £51m of capacity changed hands. The auction was again marked by limited successful activity on the part of the managing agents and by the propensity of sellers to seek a floor price. This latter factor meant that more than half of tendered capacity remained unsold despite strong demand, generally from third party buyers. It seems that many of the new entrants satisfied their capacity requirements in Auctions One and Two and there were some interesting bargains as prices fell an average of 18%.

Who traded and at what price?

The capacity of 27 syndicates was traded, up from a total of 26 in Auction Two, with a small amount of Syndicate 3334 changing hands for the first time since its formation. The only syndicate open to third party capital that did not trade at all this year is Syndicate 2007, where bids of 8p and above were insufficient to tempt any of the remaining £1.6m of non-aligned capacity.

The spreads between the highest price and lowest price paid for the capacity of any given syndicate continued to be very broad. We calculate that, for 8 of the 27 syndicates traded, this spread was more than 10p.

Our index of the average value of all third party capacity fell almost 18% over Auction Two levels, to 19.65p per £1 of capacity. This is still a level almost twice the 2006 Index of 9.98p (after adjusting for de-emptions and pre-emptions for 2007).

Weighted Average Price of Capacity	
All 2006	10.04p
All 2006 adjusted*	9.98p
Auction 1. 2007	25.82p
Auction 2. 2007	23.91p
Auction 3. 2007	19.65p
All 2007	22.69p

*for pre-emptions and de-emptions

Our expectation of a further fall in pricing levels following Auction Two was met and there were some astute purchases made. One buyer bought a £78,000 line on

Syndicate 33 at 8.9p (the lowest price paid in Auction Two being 18p). Others bought Syndicate 510 at less than 11p (minima in Auctions One and Two 18p and 16p respectively) and Syndicate 2791 at less than 15p (20p in Auction One and 21p in Auction Two).

Buyers

Once again, the managing agents' attempts to buy in managed capacity met with little success. Hiscox, Kiln, Limit, Beazley, and Equity have not increased their shares for 2008.

Top five buyers of capacity on a single Syndicate at Auction		
Syndicate	**Amount Bought**	**Buyer**
6101	4,068,732	Hampden MAPA 7208
510	3,200,000	Hampden MAPA 7208
557	3,000,000	Hampden MAPA 7215
1200	2,500,000	Heritage Nameco
33	2,100,000	Hampden MAPA 7208
218	2,100,000	Hampden MAPA 7208

Chaucer set a new high price paid for capacity with a bid at 126p for Syndicate 1176 in Auction Two. It bid for another £3.5m in Auction Three, but ended up with less than £3,000 as non-aligned buyers snapped up most of the £138,000 on offer at prices ranging from £1.42 to £1.30.

Atrium was another with high aspirations, bidding for £15m at 15p per £1 of both managed Syndicates 570 and 609 in each auction this year. The fall in overall prices just brought Syndicate 570 into range and Atrium's persistence was rewarded with a purchase of £80,000.

Meacock Capital added £900,000 to its £5.8m share of Syndicate 727.

Heritage was a buyer of capacity on managed Syndicate 1200 for the first time. It bought £2.5m at 5p. Crucially, as Heritage's share now stands at more than 75%, it will be required to make a Mandatory Offer to the remaining non-aligned members and this purchase sets the minimum level for this offer.

As in 2006, Cathedral showed itself to be prepared to up its bidding through the auctions. Auction Three's bid of 38.2p for £20m secured another £1.1m. Other buyers outbid Cathedral to acquire £235,000.

Sellers

Top five sellers of capacity on a single Syndicate at Auction based on trades over £100,000		
Syndicate	**Amount Sold**	**Seller**
2121	4,608,882	Aligned Nameco
6101	3,637,380	ICP Capital
218	1,984,633	ICP Capital
623	1,850,000	Private Nameco
510	1,659,345	ICP Capital

The most notable development of 2007's Auction Season has been the propensity of sellers to become much more price sensitive. In the past, most sellers were resigning members, who faced the choice of selling for whatever the going rate may be or of handing unsold capacity back for nil value. Given the mechanics of the auction, whereby sale capacity is allocated first to those specifying the lowest price, there was a positive incentive in Auction Three to place the lowest possible reserve (0.1p) on sale capacity.

Of the total £104m tendered in Auction Three, 28% was tendered at less than 1p, and a further 16% at 6p or less. The balance specified various floor prices up to the rather optimistic (and seemingly somewhat arbitrary) 184p wanted by one seller for his £100,000 line on Syndicate 609.

In consequence, only £51m of the tendered £104m was matched with buyers. About £3m of this balance was swept up in interaction with the six bilateral deals, leaving sellers with some £50m of underwriting that they will presumably be willing to support for 2008.

The two most heavily traded syndicates were Kiln Syndicates 510 and 557, the latter of which, having traded as high as 9p in Auction One, was generally available at less than 1.0p

ICP General Partner, a spread vehicle, reduced its exposure for 2008 by selling another £12.3m in bilateral deals with Hampden MAPAs. ICP sold £2.7m in Auction Two. For 2007, ICP's Premium Income Limit is £100m.

Price Rises

Major percentage increase in value for trades over £100,000			
Synd	2007 Auction 2 Price	2007 Auction 3 Price	Increase in Value
4040	0.11	0.14	24.8%
1200	4.71	5.24	11.2%
1176	126.20	133.00	5.4%
623	17.94	18.78	4.7%
2010	37.34	38.45	3.0%

Price Falls

Major percentage decrease in value for trades over £100,000			
Synd	2007 Auction 2 Price	2007 Auction 3 Price	Decrease in Value
557	7.61	0.65	(91%)
6102	3.68	1.12	(70%)
2121	6.54	2.85	(56%)
6101	3.35	1.55	(54%)
6103	3.31	1.63	(51%)

Argenta MAPA Portfolios for 2008

In our Pre-Auction Three Disclosure we published the constitutions of the Argenta MAPAs after two auctions. As advised, the constitutions for MAPAs 7006 and 7049 after three auctions have not changed. The constitution of MAPA 7007 has changed as capacity was acquired in the third auction, although the changes are not material. Orders for capacity on MAPA 7007 have been satisfied in full at a cost of 24.52p per £1 of capacity.

The expected final constitution of each of the MAPAs is shown below. These will remain unchanged unless the business plan of any of the underlying syndicates is not approved and/or there is a change to any of the individual syndicate pre/de-emptions.

The would-be cost of acquiring the 2008 MAPA capacity at average auction prices was 25.78p for MAPA 7006, 20.74p for MAPA 7007 and 24.27p for MAPA 7049

A final MAPA brochure will be published in January 2008.

Syndicate	MAPA 7006 %	MAPA 7007 %	MAPA 7049 %
33	9.7	15.5	10.1
218	9.1	6.5	8.9
318	5.3	5.9	6.4
386	7.2	-	4.2
510	11.4	16.8	11.1
557	4.5	6.1	5.3
570	3.3	4.2	4.4
609	8.0	5.9	6.8
623	5.7	7.8	6.6
807	-	5.1	3.6
958	8.0	10.8	7.7
2010	7.6	-	7.8
2121	4.7	4.2	-
2791	4.8	7.8	6.5
6102	10.7	0.9	10.6
6103	-	2.5	-
Total	100.0	100.0	100.0

Note: A detailed description of the underwriting business of each syndicate, along with the APCL rating attributed to each, is included within the APCL Syndicate Profiles Book, published in August 2007. Syndicates 2121, 3334 and 6102 are managed by Argenta Syndicate Management Limited, a wholly-owned subsidiary of Argenta Holdings plc, which is also the parent company of APCL.

Members' Charges for 2008

Lloyd's Council has approved the New Central Fund (**NCF**) contribution rates and member's subscription, entrance and application fees for 2008. The principal charges are the cessation of the syndicate loans to the NCF and a change to the basis of charging from *allocated* capacity to *written* premium income.

The principal charges are :-

	2007 % of Capacity	2008 % of Written Premiums
NCF Contributions	1.00%	0.50%
Members' subscriptions	0.50%	0.50%
Syndicate Loans to NCF	0.75%	-
Total	2.25%	1.00%

With anticipated utilisation of 2008 capacity being close to 80% on average across the Argenta client base, this represents approximately a 60% reduction in NCF contributions and a 20% cut in subscription levels. Initial contributions will be based on capacity, with subsequent adjustments according to the level of written premium income. In the event of syndicates over-writing their capacity, charges will be scaled up accordingly.

New corporate members participating on one or more new syndicates pay increased NCF contributions of 2% of written premiums for the first three years of their membership.

Syndicate loans were discontinued in July 2007, with all amounts repaid to Members following the £500m tier one debt issue.

RJ Kiln & Co Limited Syndicates 510 and 557

In a Pre-Auction One disclosure, RJ Kiln & Co Limited (**RJ Kiln**) outlined its proposal that Syndicate 557 should become a quota share reinsurer of Syndicate 510 with effect from the 2008 year of account. The main points were:

- The business written previously as a co-insurer with Syndicate 557 will be written by Syndicate 510, but the Syndicate 557 share will be reinsured out to Syndicate 557 through a quota share reinsurance.

- In the event that Syndicate 557 ceases trading and the Reinsurance Division of Syndicate 510 continues to write business RJ Kiln, in its capacity as Managing Agent, will seek a merger with Syndicate 510, subject to meeting the requirements of the Major Syndicate Transactions Byelaw (No. 18 of 1997).
- The arrangement with W.R. Berkley Insurance (Europe) Limited to write catastrophe reinsurance in consortium with Syndicates 510 and 557, which commenced for the 2005 year of account, will terminate at the end of the 2007 year of account.

We have now had the opportunity to discuss these proposals with RJ Kiln and to review the revised business forecast submitted to Lloyd's on 20 September.

Members should refer to the 2007 Argenta Syndicate Profiles, published in August, for full background information. Our assessment of recent developments is as follows:

Background

RJ Kiln first proposed this arrangement two years ago. Because of its relatively small size in the global reinsurance market, the security of Syndicate 557 was increasingly being questioned. Following the 2005 hurricanes, capacity of the sort provided by Syndicate 557 was in short supply and fewer questions were asked about security as buyers were prepared to take what was available. There are now signs that, despite the increase in the capacity of Syndicate 557 from £55m in 2006 to £120m for 2007, these issues are re-emerging. RJ Kiln believes that the new arrangement will bring operational advantages to its reinsurance division, in the form of a larger gross line for Syndicate 510, and will not prejudice the position of Syndicate 557, which will continue to participate in that reinsurance account. Having to explain and account for the separate parts of the RJ Kiln reinsurance line (510/557/Berkley) has become an increasing irritant to the managing agency and brokers.

Premium income

The Syndicate Business Forecast (**SBF**) submitted to Lloyd's at the end of June projects gross premium income for Syndicate 557 as £26.5m, which represents 22% of capacity. In the September SBF this increases to £28.2m or 23.5% of capacity.

It might have been expected that, with the ending of the Berkley consortium, premium income to Syndicate 557 would increase by more than this. However, following the July reinsurance renewals Kiln has revised downwards its premium income forecasts for its reinsurance division (which includes Syndicate 510) for both 2007 and 2008.

There are two principal reasons for this: first, a weaker US dollar results in less premium income when accounted in sterling; and secondly, a number of buyers of reinsurance are dropping lower levels of cover as the price is very high and they can use the savings to buy larger limits of indemnity to protect against larger losses.

Realistic Disaster Scenarios (RDS)

In order to operate closer to the Franchise Performance Directorate's guidelines on RDS, Syndicate 557 has, since 2005, been required to restrict premium income to a low percentage of capacity. The proposed quota share arrangement has not changed that requirement and, subject to the business plan being approved, capacity will remain at £120m for 2008.

The table below compares the seven largest RDS, as a percentage of capacity, between the June and September 2007 SBFs. It can be seen that, with one exception, the RDS have increased by between three and five percentage points between June and September. We will shortly be sending out a revised PePA to all bespoke participants which will incorporate the recent figures.

	June SBF		**Sept SBF**	
	Gross %	Net %	Gross %	Net %
Two Events	73	44	77	49
Florida Windstorm (Tampa Bay)	49	32	54	36
North East Windstorm	48	32	47	31
Gulf of Mexico Windstorm	41	25	45	28
California Earthquake (San Francisco)	35	20	39	24
California Earthquake (Los Angeles)	34	19	39	24
Florida Windstorm (Miami)	32	17	35	19

The FPD maximum RDS guidelines are respectively 75% and 20% gross and net of syndicate capacity.

Expenses

One of the reasons why RJ Kiln shelved its plans for the quota share arrangement when first proposed two years ago was that Lloyd's intended charging Syndicate 510 the NCF levy in respect of that portion of Syndicate 510 capacity to be utilised for writing business that would then be reinsured with Syndicate 557, thus resulting in a double charge (because Syndicate 557 also pays the NCF levy). For the 2008 account, the rate at which the NCF contribution is charged has reduced from 1% to 0.5% (see page four) and, importantly, it is to be charged as a percentage of gross written premium, rather than capacity. Although Lloyd's is still not prepared to make any concessions as regards the charging structure agreed two years previously, these changes make this much less of an issue. RJ Kiln has informed us that it believes that the proposed quota share arrangement is expenses neutral for Syndicate 557.

Merger

The undertakings that RJ Kiln has given as regards a merger with Syndicate 510 in the event that Syndicate 557 ceases to trade has caused speculation that this is likely to happen in the short term. Nothing has arisen from our discussions with RJ Kiln to suggest that there is any such agenda. On the contrary, RJ Kiln has made clear to us that Syndicate 557 will continue for so long as third party capital wishes to support it.

Personnel

In late June, RJ Kiln announced a company reorganisation, which included the appointment of David Huckstepp as underwriter of Syndicate 557 and of the reinsurance division of Syndicate 510, following the departure of Andrew Carrier. At the same time Matthew Wilken, who had worked in the reinsurance division for many years, was appointed deputy. We have since learned that Matthew Wilken has left the company and is rumoured to be joining Andrew Carrier at his new home next year, after the expiry of his contractual notice period. Although this leaves the reinsurance team depleted, a replacement is being actively sought and RJ Kiln is confident that it has the critical year-end renewal season covered. In the longer term, the 'ex RJ Kiln' team will no doubt use their broker relationships to try to secure business, but we do not foresee this being a major threat to the RJ Kiln reinsurance brand, which continues to be strong. We are confident that RJ Kiln is capable of managing these matters, although we will of course be monitoring developments.

Conclusion

We are supportive of RJ Kiln's quota share proposals and believe that they will bring benefits to both Syndicates 510 and 557. We also believe that the undertaking to seek a merger with Syndicate 510 in the event that Syndicate 557 ceases protects the position of capital providers.

We do however consider that these recent developments merit an ability for members to trade their Syndicate 557 capacity in Auction Four on 15/16 November. Accordingly, we intend submitting a request of the Auction Official to exercise his discretion in permitting this. The Auction Official is due to announce details of any syndicates which will be admitted in Auction Four on 31 October. We have previously advised members of the criteria (generally comprising of material changes to syndicates' business plan) which need to be satisfied as part of this consideration and will provide a further update in this regard as soon as the Auction Official's decision is forthcoming.

Auction Three, 2007 Summary

Syndicate	Premium p per £	Capacity Allocated (£)	Value (£)	Auction 1 Price	Auction 2 Price
33	15.60	2,508,175	391,225	28.00	25.00
218	29.80	1,539,926	458,898	28.01	30.82
260	14.49	1,150,739	166,777	16.92	17.50
308	18.26	120,000	21,917	0.00	25.00
318	21.10	628,620	132,639	20.82	22.13
386	71.96	887,476	638,583	113.80	82.56
510	13.98	7,882,437	1,101,649	23.88	20.16
557	0.65	6,653,531	43,381	9.00	7.61
570	21.18	965,463	204,504	33.07	31.90
609	21.05	1,687,936	355,226	37.20	33.24
623	18.78	4,161,148	781,547	14.79	17.94
727	16.60	1,608,625	267,048	26.73	22.00
779	19.50	596,338	116,286	28.77	31.14
807	6.61	1,290,529	85,304	4.98	9.48
958	12.71	1,566,045	198,997	18.43	18.02
1176	133.00	137,950	183,478	90.44	126.20
1200	5.24	4,370,352	228,919	4.11	4.71
2007	0.00	0	0	0.00	0.00
2010	38.45	1,373,932	528,236	34.70	37.34
2121	2.85	5,573,511	158,845	1.44	6.54
2525	19.42	205,699	39,947	26.27	24.00
2526	11.90	475,572	56,607	19.50	19.00
2791	19.90	1,868,717	371,875	24.26	25.12
3334	3.84	80,000	3,070	0.00	0.00
4040	0.14	668,682	909	0.14	0.11
6101	1.55	1,146,456	17,804	3.73	3.35
6102	1.12	801,542	8,969	4.20	3.68
6103	1.63	1,194,000	19,486	3.81	3.31
27 syndicates traded	**12.87p**	**51,143,401**	**6,582,127**	**16.64p**	**23.18p**

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The capacity of six syndicates was also traded in Bilateral deals.

Syndicate	Bilateral Price	Auction Interaction		Bilateral Capacity	Total Capacity
		Tenders	Subscriptions		
33	22.0	707,500	0	1,392,500	2,100,000
218	31.0	115,367	0	1,984,633	2,100,000
260	17.0	24,464	0	1,500,000	1,524,464
510	19.0	1,540,655	0	1,659,345	3,200,000
6101	3.3	431,352	0	3,637,380	4,068,732
6103	2.9	136,857	0	1,180,000	1,316,857
Total	**15.04p**	**2,956,195**	**0**	**11,353,858**	**14,310,053**

Connected Parties

The following Auction Three transactions were successfully entered into by Members with APCL 'connected person' status:-

Syndicate	Subscription / Tender	Capacity £	Director / Staff / Council Member / Group Corporate Member
0218	Subscription	50,000	West Sussex Partners Limited (054212B)
0510	Subscription	50,000	West Sussex Partners Limited (054212B)
2526	Subscription	40,000	West Sussex Partners Limited (054212B)
2526	Subscription	40,000	West Sussex Partners Limited (054212B)
2526	Subscription	40,000	West Sussex Partners Limited (054212B)
2526	Subscription	50,000	West Sussex Partners Limited (054212B)
0033	Subscription	45,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0218	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0218	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0386	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0557	Subscription	27,984	Talisman Corporate Underwriting 2000 Ltd (054491F)
0570	Subscription	50,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0609	Subscription	50,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0623	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
0623	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
2791	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
2791	Subscription	25,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
2791	Subscription	45,000	Talisman Corporate Underwriting 2000 Ltd (054491F)
2121	Tender	847,723	Argenta Underwriting No 4 Limited (055380X)

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