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Volume 46, numéro 4, 1979

URI : <https://id.erudit.org/iderudit/1103996ar>

DOI : <https://doi.org/10.7202/1103996ar>

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Éditeur(s)

HEC Montréal

ISSN

0004-6027 (imprimé)

2817-3465 (numérique)

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Citer ce document

Robey, C. (1979). Lloyd's – The American Challenge. *Assurances*, 46(4), 366–373.
<https://doi.org/10.7202/1103996ar>

Lloyd's – The American Challenge

by

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In its almost three hundred years, Lloyd's of London has faced and rebuffed many challenges, however 1978 has seen a concerted challenge on its position from the United States, on several fronts.

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In London, Lloyd's is again anticipating a near record number of applications for membership for 1979, many coming from Americans, and American brokers are obtaining access to the previously closed Lloyd's market either through acquisition of an interest in established Lloyd's brokers or complex agreements to combine their interests with a Lloyd's broker while keeping their shareholdings separate. In the meantime, in New York, legislation has been passed establishing a free trade zone, designed to retain in New York large and specialty risks which were previously the almost exclusive domain of Lloyd's, and to chart the course for an insurance exchange modeled on Lloyd's itself.

Although the free trade zone and the insurance exchange resulted from the same original study and saw the light of day together, even being combined into the same legislation, they are in fact two separate measures with different goals, their greatest similarity being the challenge they are specifically designed to represent to Lloyd's.

The free trade zone took effect the 1st September 1978 with the issuance of Regulation 86 by the Insurance Department of the State of New York. This regulation was issued under a modification to the Insurance Law of the State of New York which was made in legislation signed by the Governor of New York in July of 1978.

Policies which can be written in the free trade zone are those which will produce a minimum annual premium of \$100,000 for at least one class of insurance, or \$200,000 for all classes covered, when the policies cover only a single entity or two or more related entities under the same majority ownership. In addition, certain high hazard or hard-to-place risks specified in the regulation fall within the scope of the zone — the first listing of such risks includes some 300, ranging from

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all risks physical damage on tombstones to space travel accidental death and dismemberment. The regulation was met with mixed reaction by the insurance community, since it proved not to represent the degree of deregulation earlier publicity had suggested.

The primary goal of the free trade zone is to permit the writing of larger or specialty risks without the necessity of rate and form filing with the Department of Insurance, because of the trouble and delays which can result from such filings, problems which frequently meant that the business was placed on the non-admitted market, led by Lloyd's. An additional advantage is the exemption from premium tax for risks not located in the State of New York.

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However, risks located in New York State are still subject to the minimum policy provisions which, for example, may well prevent the writing of excess insurance over self-insured retentions, and also policies on a claims made basis — medical malpractice insurance coverage on a claims made form is specifically prohibited by the regulation.

In addition, although the financial requirements for being licensed in the free trade zone are not restrictive — a minimum policyholder's surplus of \$4 million, twice the minimum for a regular New York license, and \$1,000 annual license fee — a company's premium from the free trade zone, after deduction only of reinsurance placed with other members of the free trade zone, may not exceed the greater of 20% of its policyholder's surplus or so much that its total net premiums will exceed twice its policyholder's surplus. Overriding these limitations is a further one restricting the free zone premium to 25% of the total net premiums written, unless prior approval has been obtained from the Superintendent. For life and accident and health companies, net premiums per line are limited to 1% of the total net premiums written for the same line in the previous year.

Ten licenses were issued at the inception of the free trade zone, the first to the American Home, the others to five other members of the American International Group, one to INA, two to members of the Commercial Union Group and one to the United States branch of the Tokio Marine and Fire. Other licences issued since have been to two members of the Atlantic Group, two of the Continental Group and to a subsidiary of Frank B. Hall.

The first policy was written by the Insurance Company of the State of Pennsylvania, a member of the American International Group,

for a large chain of retail food stores. After about a month of operation, American International companies were the only ones to have received formal submission of risks, although others had received general inquiries from brokers.

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The free trade zone's twin, the insurance exchange began life as the reinsurance exchange, however its role was extended to include risks located outside the United States and United States risks declined by the Free Trade Zone.

While the rules for the zone were quickly set out and the zone itself became operational only months after the introduction of the legislation concerning it, the insurance exchange will not begin operations until 1979 and is not expected to get fully underway before 1980.

The legislation permitting creation of the exchange was drafted in general terms and appointed a representative committee to formulate its by-laws and regulations. These by-laws and regulations must be presented to the legislature, which will then have 45 days to object, failing which they will be automatically approved.

Although much of the planning of the exchange is still under way, enough has become known to draw certain distinctions between it and Lloyd's. First of all, syndicates themselves will be members of the exchange, rather than individuals. Secondly, the liability of each syndicate will be limited, whereas the liability of a member of Lloyd's is unlimited. Minimum capital and surplus requirements for the syndicate will probably be in excess of \$3.5 million with the minimum investment for each syndicate member set at \$100,000.

The exchange will establish a guarantee fund, started off by a deposit from each organization which becomes a member and built up subsequently by an assessment on premium.

Brokers which wish to place business with the exchange will need to be licensed in the State of New York and, probably, by the exchange itself, as is the case with Lloyd's. However, unlike Lloyd's, brokers will also be represented on the governing committee and may also, as a corporation, invest in a syndicate, although they will be limited to less than a 20% participation. The involvement of brokers and individuals in a syndicate represents one of the goals of the exchange, to attract new capital to the industry. However, it seems probable that most syndicates will be comprised of insurance companies, either American or foreign, so that the amount of actual new capital developed may be only a small part of the total capital invested in the exchange and will thus represent more a displacement of existing capital; nonetheless, such displacement would probably represent a greater use of capital available and would certainly increase the admitted capacity available in the United States.

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Perhaps the future of both the zone and the exchange will depend on two potential problems — the presence of sufficient underwriting talent and the absence of regulation by the Department of Insurance.

While the threat of over-regulation — already invoked by many insurers which have switched their preference from the zone to the exchange — is somewhat outside the control of the insurance industry, the search for underwriting talent is not and, for the first few years of the existence of the zone and the exchange, it is probably in this area that Lloyd's will meet its greatest competition, since Lloyd's will inevitably be the target for recruiters seeking underwriters, particularly for the exchange. This is already evident in the advertisements appearing in trade journals and the activities of specialist recruitment companies. It has been suggested that Lloyd's itself is not over-stocked with first class underwriters and a further dilution of underwriting talent could result in a lessening of underwriting standards throughout the reinsurance market and mean that the exchange would begin operations in a most competitive market.

Meanwhile, activities in London suggest that American brokers do not consider the demise of Lloyd's as imminent.



Early in April of 1978, it became known that Frank B. Hall, fourth largest broker in the United States, was seeking to take over Leslie and Godwin, tenth largest broker in Great Britain, and that Marsh and McLennan, largest broker in the world was seeking to take over Wigham Poland. On the 19th April 1978, the committee of Lloyd's published a ruling restricting the degree of ownership of a Lloyd's broker by outside insurance interests and these two takeovers, together with two others which were not publicly known, were stated as not meeting the new requirements. Nonetheless, by the end of the year, Frank B. Hall had purchased nearly 100% of Leslie and Godwin, except for the Lloyd's broking interest, of which they had 25%; Marsh & McLennan had announced plans to link their operations, without equity merger, with the C.T. Bowring Group, the largest brokers in Great Britain; Continental East of the United States, through Swett and Crawford, had purchased 20% of Harris and Dixon; Bland Payne and Sedgwick Forbes, both of London, were planning to merge their operations and then link them with Alexander and Alexander, the third largest broker in the United States, which is in turn taking over R.B. Jones, a smaller American broker.

The Committee of Lloyd's ruling in effect stated that no outside insurance interests may normally hold more than 20% of a Lloyd's broker and their power for enforcing this rests in their ability to refuse to renew the brokers license to transact business at Lloyd's — a powerful weapon indeed. Although it appeared to be a hurried decision, coming so quickly on the heels of the announcement concerning the plans of Frank B. Hall and Marsh & McLennan, it was in fact the result of a study which had been under way for some time, following legislation in Great Britain concerning the registration of brokers. The purpose of the ruling is to permit the committee of Lloyd's to exercise its powers of self-regulation effectively and it was felt that, for it to do this, it was necessary for the control of Lloyd's brokers to rest firmly in the hands of people who have long experience in the working of the Lloyd's market.

For some time, American brokers had been dissatisfied with their lack of a direct access to a market as important as Lloyd's, particularly in view of the amount of United States business transacted on that market, so it was no surprise to learn of the four possible mergers in April of 1978.

Following Lloyd's action, Marsh & McLennan ceased their negotiations with Wigham Poland and, as became apparent subsequently, sought other means to gain entry to Lloyd's, which would bypass the committee's ruling. Frank B. Hall, on the other hand, continued their discussions concerning the take over of Leslie and Godwin privately, but consulted also with the committee of Lloyd's, so that the formula which would eventually be arrived at would be acceptable to the committee.

In the final analysis, both the committee and Frank B. Hall, on paper at least, have obtained what they sought from the subsequent arrangement. Frank B. Hall purchased over 90% of Leslie and Godwin Holdings, on the understanding that the Lloyd's activities would be concentrated in a single company, Leslie and Godwin International, in which Frank B. Hall would reduce their interest to 25%, the remaining 75% being in the hands of interests acceptable to the committee of Lloyd's.

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In effect, the committee of Lloyd's ruling is satisfied, since the 25% is actually diluted by shares held by management to less than 20%, while Frank B. Hall will be able to exercise substantial control of the operations of Leslie and Godwin International, through their 25% ownership, the similarity in the name with that of the Frank B. Hall subsidiary and, undoubtedly in time, control of much of the business handled by Leslie and Godwin International.

Shortly after the Lloyd's ruling, it was announced that Swett and Crawford, a subsidiary of Continental East, was refused permission by the committee of Lloyd's to purchase more than 20% of Harris and Dixon, one of the oldest Lloyd's brokers, established in 1797. Although nothing was heard for a while afterwards, it was made public in the autumn that Swett and Crawford had indeed purchased a participation in Harris and Dixon, but had limited it to the 20% prescribed by Lloyd's.

The ruling of the committee of Lloyd's was not retroactive and several Lloyd's brokers are controlled by outside insurance interests with others having substantial minority shareholdings by such interests. One of these is Glanvill Enthoven, in which Corroon and Black of the United States have a 35% interest; there would seem to be no intention on the part of the committee to force such companies to reduce the outside interest to 20%.

These developments held the interest of the broking community until they were eclipsed on the 24th September 1978 by the announcement of a proposed linkup, but not equity merger, between Marsh & McLennan and C.T. Bowring. The resultant grouping would be by far the largest broking organization in the world. Their linkup would be based on equalization of earnings between the two companies, with cross-representation on each other's boards, but no exchange of equity, Marsh & McLennan and C.T. Bowring remaining each one in sole ownership of their respective parts of the group. With the announcement not long after of the merger in London of Sedgwick Forbes and Bland Payne (20% owned by Marsh & McLennan and perhaps the original target of their take-over plans) and a subsequent linkup, presumably similar to the Marsh & McLennan/C.T. Bowring one, with Alexander and Alexander in the United States, the multinational broker appears to be the wave of the future.

The new links being forged between United States and London brokers brings into question the existing relationship which those brokers have on each other's markets. Marsh & McLennan, which will presumably divest itself of its 20% interest in Bland Payne, deals either directly or through subsidiaries with Sedgwick Forbes, Matthews Wrightson, Alexander Howden, Willis Faber, Bland Payne and undoubtedly others, in addition to C.T. Bowring. Frank B. Hall and Alexander and Alexander also have different London contacts and the London brokers involved may deal with several American brokers. Undoubtedly there will be no immediate switching of business, since the nature of insurance and reinsurance transactions makes them unsuitable for rapid changes in the handling brokers. However, any London broker with a sizeable portfolio, for example, from Marsh & McLennan, must be looking to the future and wondering how long that portfolio will remain with them, and would certainly be thinking of what defensive measures it may take by developing other sources of business from the United States and also openings into that market for its own business.

The American interest in Lloyd's, in all its forms, only serves to underline the high standing in which it is held after three hundred years of operation. In developing from a coffee house to dealing with the complexity and worldwide scope of modern business, it has shown an adaptability which has kept it in the forefront of insurance markets and the emergence of two new challenges in New York is likely to do no more than make Lloyd's call again on that ability to adapt. Indeed, whatever their nature, the free trade zone and the insurance exchange

represent no more than new markets coming on the scene to add to the already rapidly expanding number of entities handling insurance and reinsurance worldwide. As they develop, they will find their place in the market and other markets, such as Lloyd's will adapt to them and prepare to face the next challenge, from whatever direction it may come.

La croissance économique au Canada. Dans son allocution de fin d'année, le président de la Banque Provinciale du Canada a passé en revue le bilan économique de 1978. Voici un extrait de son discours:

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« Le bilan économique de l'année qui s'achève n'est certes pas aussi favorable que plusieurs le prévoyaient il y a un an, mais il n'est pas non plus aussi mauvais que certains le prétendent.

« L'analyse de la conjoncture actuelle révèle en effet que depuis l'année dernière des progrès ont été enregistrés dans plusieurs domaines. Ainsi la croissance de l'économie canadienne s'est améliorée, passant de 2.7 % en 1977 à près de 4.0 % probablement cette année. La hausse des salaires a été ramenée à des proportions raisonnables et l'évolution des coûts unitaires de main-d'œuvre se compare maintenant favorablement à celle des États-Unis, notre principal client et fournisseur. Notre compétitivité s'est renforcée en raison de la baisse du taux de change du dollar canadien. De fait, l'augmentation de l'excédent de notre balance commerciale témoigne du renforcement de la position concurrentielle des produits canadiens. Enfin, l'amélioration de nos coûts de production s'est traduite par une modération du taux de l'inflation de base.

« Ces quelques progrès ont entraîné un certain regain de confiance, tant de la part des consommateurs que des chefs d'entreprise. Conjugué à la bonne tenue de nos exportations, ce facteur a contribué à accélérer la production industrielle et la création d'emplois. L'amélioration de la situation financière d'un bon nombre de sociétés a incité celles-ci à accroître quelque peu leurs investissements. Au Québec, en particulier, l'augmentation sensible des investissements privés dans le secteur de la fabrication est encourageante. On constate donc, au total, un certain assainissement de la situation.

« Cela ne signifie pas toutefois que tout va pour le mieux dans le meilleur des mondes. »