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Lloyd's of London

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Résumé de l'article

Courtier en réassurance, notre collaborateur Christopher J. Robey est bien placé pour décrire l'institution des Lloyds, ce grand marché mondial d'assurance et de réassurance, formé de syndicats et qui constitue une bourse d'assurance plutôt qu'une compagnie d'assurance. Après avoir décrit la structure et la composition des membres, notamment l'acceptation de membres corporatifs en 1994, il examine, chiffres à l'appui, les règles de sécurité entourant la solvabilité des membres et la constitution d'un fonds fiduciaire des primes. Puis, il analyse les résultats financiers des dernières années, dans la foulée des sinistres qui ont atteint un niveau inégalé dans l'histoire des Lloyds. Face aux déficits consécutifs depuis 1988, l'auteur décrit les mesures indispensables prises à court terme, en 1993, pour redresser ce grand marché et les perspectives à plus long terme, à partir de l'année 1996. Finalement, l'auteur commente brièvement les opérations canadiennes et américaines des Lloyds.

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by

Christopher J. Robey*

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Structure

Lloyd's does not accept insurance and reinsurance. It is rather a place where individuals and corporations accept insurance and reinsurance.

The individuals, known as "individual members" or "Names", and the corporations, known as "corporate members", accept business by participating in syndicates which, through managing agencies, underwrite and administer the risks on their behalf. Corporate members deal directly with the managing

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agencies, while individual members do so through members' agencies.

The liability of corporate members is limited to their capital, while that of individual members is unlimited. Members are only liable for their own losses. They are not liable for the losses of other members on their syndicate, nor for the losses of other syndicates.

Membership

Lloyd's traditional base of members was wealthy British men, however the capacity demands beginning in the nineteen sixties caused concern that this base would provide insufficient capital for the future. As a result, Lloyd's widened the membership in stages until, at the end of the sixties, it was open to anyone with sufficient resources.

Following poor results at the end of the nineteen eighties, it became evident that some individual members, particularly the newer ones, were concentrated on fewer and higher risk syndicates, resulting in their suffering a disproportionate share of the losses Lloyd's made during that period. As a result, since 1994, individual members can choose to participate in new structures known as "Members' Agent Pooling Arrangements". Under these structures, a members' agent pools underwriting capacity and those individual members it represents who so choose share proportionately in a pre-arranged spread of syndicates.

The 1994 underwriting year was also the first in which corporate members participated. In that year, 95 corporate members provided 15% of the total capacity of Lloyd's. This increased to 140 in 1995, supplying 23% of the total capacity, and 165 in 1996 providing 44% of the total capacity. Several of the new corporate members are backed by insurance companies.

It is anticipated by many commentators that the membership will switch exclusively to corporate members, although this would be a gradual process taking at least a generation. Those individual members still underwriting have clearly a strong commitment to Lloyd's and are therefore unlikely to withdraw until their personal circumstances require it. However, it is anticipated that there will be few new individual members.

Security

Each year, Lloyd's tests each member for solvency to ensure that that member has sufficient funds at Lloyd's to support its underwriting. Any shortfall must be met immediately for the member to continue.

In addition, Lloyd's itself is subject to an annual solvency test conducted by the United Kingdom Department of Trade and Industry. In the most recent solvency test, as at December 31, 1994, Lloyd's covered the required solvency margin 3.9 times, compared to 3.0 times for 1993 and 2.2 times for 1992.

Cumulatively, at the end of 1994, Lloyd's had total assets of £27,665 million, against outstanding liabilities of £21,078 million, leaving net resources of £6,587 million. The ratio of net resources to net premium was 0.9:1. However, since the liability of members is several, not joint, not all these funds are available to meet all claims.

There are three levels of Lloyd's security.

First, all premium received is put into premium trust funds, with only claims, reinsurance premiums and underwriting expenses permitted to be taken out until the account for the year is closed, currently three years following the beginning of the underwriting year.

If this is insufficient to meet all claims on the syndicate in that underwriting year, the members must make up the difference, each for his or her share of the syndicate.

First call for any additional funds needed is on the deposit which each member must place with Lloyd's. There are three levels of deposit, calculated as a percentage of the member's premium limit:

For individual members participating through a Members' Agent Pooling Arrangement: 25%.

For other individual members: 30%

For corporate members: 50%.

If this is insufficient, a cash call is made and the member must send the needed funds to the syndicate. The ability of a corporate member to do so is governed by its capitalization. Individual members must have demonstrated personal wealth of at least £250,000. The individual member's wealth over and above this minimum is also available to meet claims, since his or her liability is unlimited.

If claims cannot be collected from members, the Central Fund becomes responsible. It was established in 1927 and at the end of 1994 stood at £738 million.

Finally there are the Corporation's own assets, which were valued at £259 million at the end of 1994.

Recent Results

Lloyd's lost money in 1988 for the first time since 1967, £510 million pre-tax on £3,714 million of net premium. However, it was primarily a marine market loss, greatly affected by the Piper Alpha and Exxon Valdez claims. The 1989 year produced a loss of more than £2,063 million on £3,966 million of premium, the largest loss ever up until then. With the 1990 result, Lloyd's adjusted the numbers to eliminate a certain amount of double counting which is inherent in the system. Nonetheless, the 1990 loss surpassed that of 1989, at £2,319 million on £5,280 million of premium. This result improved in 1991, but only to a loss of £2,048 million on £6,014 million of premium. 1992 saw a further improvement, to a £1,193 million loss on £6,331 million of net premium. The total loss over the five years from 1988 to 1992 was £7,133 million.

Lloyd's closes its books for an underwriting year two years after the end of the year. Consequently, 1992 is the latest year for which results are available. Current indications are for a return to profit in 1993, 1994 and 1995. Lloyd's ability to produce a profit despite a single major catastrophe today is demonstrated by the expected profit in 1994, the year of the Northridge earthquake.

Only part of the £7,133 million loss from 1988 to 1992 came from current underwriting. Each year's results are a combination of the result of the underwriting year itself and the development of claims from prior underwriting years. In 1988, the underwriting year produced a profit of £68 million, but £578 million was applied to the strengthening of reserves. The amounts allocated to the strengthening of reserves from 1989 to 1992 were:

1989	£396 million	19% of the total loss.
1990	£1,130 million	39% of the total loss.
1991	£961 million	47% of the total loss.
1992	£836 million	70% of the total loss.

The bulk of reserve strengthening is for American asbestosis and pollution claims, and is similar to action being taken by American insurers and reinsurers. It will be many years before these claims are settled and the difficulty in establishing accurate reserves for them has meant that many syndicates have not closed the years in which these reserves must be set up in accordance with the normal three-year accounting process.

Aftermath of the Losses

Triggered by the poor results, a number of lawsuits have been started by members against managing agencies, members' agencies and Lloyd's itself. Many are resisting meeting cash calls until the lawsuits are decided. Many have also sought injunctions to prevent Lloyd's from using their deposits, although with little success.

Various sources of funds would be involved if some members were relieved of liability, principally the errors and omissions insurers of the members' agencies and managing agencies involved. These are usually other Lloyd's syndicates, so that this would have the effect of spreading the losses more widely within Lloyd's itself. Since part of the errors and omissions insurance is placed outside Lloyd's, the total liability to Lloyd's members would be reduced. The last resort is the Central Fund.

The major cases which have been heard to date have been won by the members, however there remain many questions to be resolved before they are able to collect.

Reconstruction and Renewal

In May 1995, Lloyd's produced a document entitled "Lloyd's: reconstruction and renewal" which sets out its plans to settle outstanding litigation, relieve members of liability for open years of account and start what would be a "new Lloyd's" beginning with the 1996 underwriting year.

The "Old Market" — 1992 and Prior Underwriting Years

The business plan for Lloyd's issued in April 1993 included plans for the creation of a reinsurance vehicle which would assume the liability for all outstanding losses from underwriting years prior to 1986. This vehicle, now known as Equitas, is in the process of being set up and it is now proposed that it take on all outstanding losses from underwriting years prior to 1993.

The main funding for Equitas will come from the normal reinsurance to close, which will be done into Equitas rather than into the earliest open syndicate year.

Two additional mechanisms are planned to enable members to pay what is in effect a reinsurance premium to Equitas:

A settlement fund of £800 million will be assembled, along with £2 billion in debt credits, and offered to members in return for their giving up their rights to litigate in respect of liabilities from 1992 and prior.

In anticipation of the abandonment of the three-year accounting process in favour of annual accounting, an early release of profit in the 1994 and 1995 years will be allowed in 1996 at the same time as the 1993 year is closed. Lloyd's estimates the profit to be distributed for the three years, after interim distributions already made, at £1 billion.

All but £100 million of the existing Central Fund will be transferred to Equitas as well, since the Central Fund has been used to guarantee some of the liabilities which Equitas will reinsure. At the end of 1994, the Central Fund had net assets of £738 million and was owed a further £586 million by members. By the end of 1995, it is estimated that the net assets will have fallen to £300 million and members' debts increased to £1.1 billion. Since the members' debts are also assets of the Fund, a total of about £1.3 billion will be transferred to Equitas, although it is recognized that some of the members' debts will not be recoverable.

Contributions will also be sought from other segments of the Lloyd's market, including members underwriting in the future, so that the total contribution to Equitas is estimated at £15.9 billion, while the discounted liabilities Equitas will assume are estimated at £15.6 billion.

The estimated net assets of Equitas, at £300 million, are sizable when compared with the net assets of many reinsurers, but are less than 2% of its liabilities, the bulk of which are at discounted value. This makes Equitas very thinly capitalized, given the nature of its liabilities and the doubtful value of some of its assets. Some changes may therefore be necessary for it to obtain regulatory approval in the United Kingdom.

However, time is on the side of Equitas, since the claims reinsured will be paid out slowly over many years. In addition, the consolidation of these liabilities in one entity, rather than individual syndicates, will enable Equitas to realize substantial administrative economies and put it in a stronger position in negotiating settlement of the claims than individual syndicates would be. Finally, it can increase its investment return by matching its portfolio to its liabilities, whereas individual syndicates, which are in effect annual joint ventures, must invest in a much shorter time frame.

Since Equitas is a reinsurance vehicle, members remain liable for all claims which Equitas will take over and, in theory, would have to pay the claims if Equitas became unable to do so. In practice, the administrative problems in unscrambling Equitas in such circumstances makes any recovery from members highly unlikely. This is not all bad for claimants; although they would lose a possible source of recovery, the setting up of Equitas itself increases their chances of recovery, and by relieving members of future liabilities, Lloyd's greatly increases its chances of obtaining their agreement to the proposed procedures.

The "Transitional Market" — Underwriting Years 1993, 1994 and 1995

With the change to annual accounting expected to be completed in 1996, underwriting years 1993, 1994 and 1995 will be closed in 1996 and outstanding losses reinsured into the 1996 underwriting year. Since these years will not contain any pre-1993 losses, which will have been reinsured into Equitas, none of them should be left open unless the syndicate is in run-off. These years therefore, in effect, become part of the "future market".

The "Future Market" — 1996 and Subsequent Underwriting Years

To all intents and purposes, the Lloyd's which will emerge from the reconstruction process will be a new Lloyd's, with few ties to the pre-1996 market.

Contributions by the future market to the "old market" will be finite both in amount and duration, so that there will be no open-ended commitment of members.

A new Central Fund will be created, on the same basis as the existing Central Fund, but it will only be available to support liabilities beginning with the 1993 underwriting year. Its initial resources will be at least £300 million, consisting of £100 million from the existing Central Fund and the right of the Council of Lloyd's to call on members for the balance without a vote. This amount will be increased over time by annual levies. Although smaller than the Central Fund has been in recent years, its guarantee also applies to a smaller pool of liabilities.

In addition, corporate members will take on an increasing role in providing Lloyd's capacity, with a resultant change in the relationship between capacity providers and the managing agencies which use it. Already managing agencies are finding that corporate members require much more information and much broader consultation than that which they have had with individual members represented by members' agents.

The Immediate Future

At the moment, the reconstruction is only a proposal. Final details will be available in the Spring of 1996 and it will not be known until then the extent to which members will accept the package and give up their litigation rights.

The triple profit release in 1996 is also subject to various approvals and, although it is based on the move to annual accounting, it does not itself signal this change, which will take longer to accomplish. The closing of 1994 and 1995 will therefore be subject to some conditions, but it is expected that the move to annual accounting will be completed before the end of 1996.

The Position in Canada

Lloyd's is licensed in Canada for property, accident and sickness, aircraft, automobile, boiler and machinery, credit, fidelity, hail, legal expense and liability — essentially all non-life classes except marine. It is licensed as a branch of a foreign company, not as a group of individuals. This means that liability for Canadian losses is joint not several. The conditions applicable to Lloyd's in the old Canadian and British Insurance Companies Act were not fully carried over to the Insurance Companies Act which replaced it in 1992. This omission was apparently inadvertent and the Office of the Superintendent of Financial Institutions is continuing on the assumption that the new act has not changed the basis of Lloyd's Canadian license.

On this basis, if an individual syndicate cannot pay a Canadian claim, other than a marine claim, it is paid out of the Canadian assets, which are the first recourse of Canadian insureds and reinsureds, not the Central Fund. As far as the Canadian assets are concerned, there is no split between the "old market" and the "future market".

All Canadian dollar premiums are put in a Canadian dollar trust fund and are subject to the same restrictions as the Canadian assets of any other branch of a foreign company. The trust fund held $877 million at the end of 1994. Lloyd's must also meet the same solvency provisions as other branches of foreign companies.

1994 net premiums in Canada were $447.6 million. The combined ratio was 79.9% and net income was $132.7 million. Net assets were $245.0 million and the net risk ratio 1.83:1. All eight T.R.A.C. tests were passed.

The Position in the U.S.A.

In the United States, Lloyd's must keep a trust fund for the benefit of its clients equal to its liabilities, including IBNR, plus $100 million; this $100 million must represent joint, not several, liability. The trust fund was set up in New York State in 1939 and falls under New York jurisdiction. All U.S. dollar premiums for all syndicates are put in this trust fund and all U.S. dollar claims are paid out of it. The trustee is Citibank NA.

In May 1995, the New York Department of Insurance reported on its first ever audit of the trust fund, as at December 31, 1993, and found it deficient in a number of areas, particularly in that it was funded net of reinsurance, whereas the regulations under which it operated require funding gross of reinsurance. The report suggested that the trust funds were underfunded by $7.75 billion on a net basis and $18 billion on a gross basis. Lloyd's contested these findings, stating that they were the result, in large part, of the inclusion in the liabilities of both U.S. based risks and those written in U.S. dollars but located outside the U.S., and thus not subject to New York State requirements.

Following negotiations between Lloyd's and the New York Department the two parties signed a new agreement concurrent with the release of the audit report. Under this agreement, Lloyd's has undertaken to:

Transfer an additional $500 million into the Central Fund U.S.A., which supports the security available to Lloyd's U.S. clients. As at December 31, 1994, this fund stood at $143.3 million.

Create two new trust funds in New York, effective August 1, 1995, one for surplus lines and the other for reinsurance, which will fund new liabilities on risks based in the United States gross of reinsurance.

The amount in Lloyd's American Trust Funds at the end of 1994 was $10,899 million, up from $9,594 million at the end of 1993.

The Lloyd's American Trust Funds provide the principal security for U.S. ceding companies. Although the bulk of the money in the funds represents several rather than joint liability, it is nonetheless reserved for U.S. dollar claims and cannot be used to meet claims in other currencies until all U.S. dollar claims have been settled. The Central Fund provides additional protection.

Conclusion

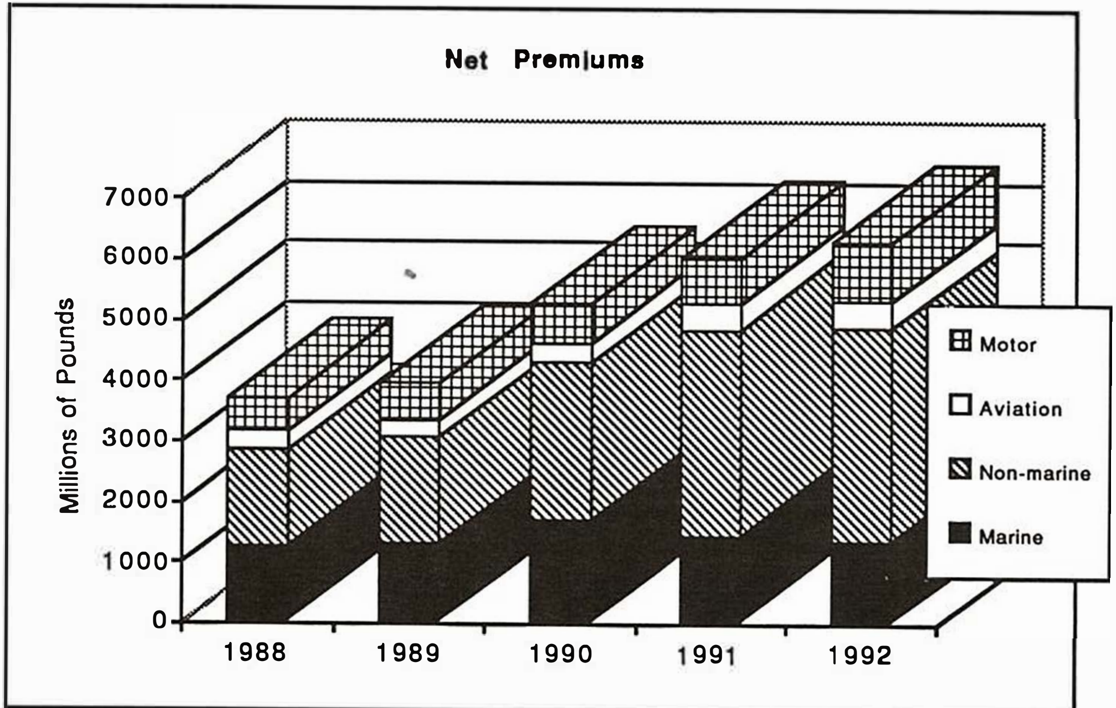
In considering the risk in dealing with Lloyd's, there are two separate periods to consider — underwriting years prior to 1993 and the "future market" beginning with underwriting years from 1993 on.

Prior to 1993, security will lie with Equitas, which, despite its low equity, should represent better security than that provided by individual members, many of whom are embroiled in litigation.

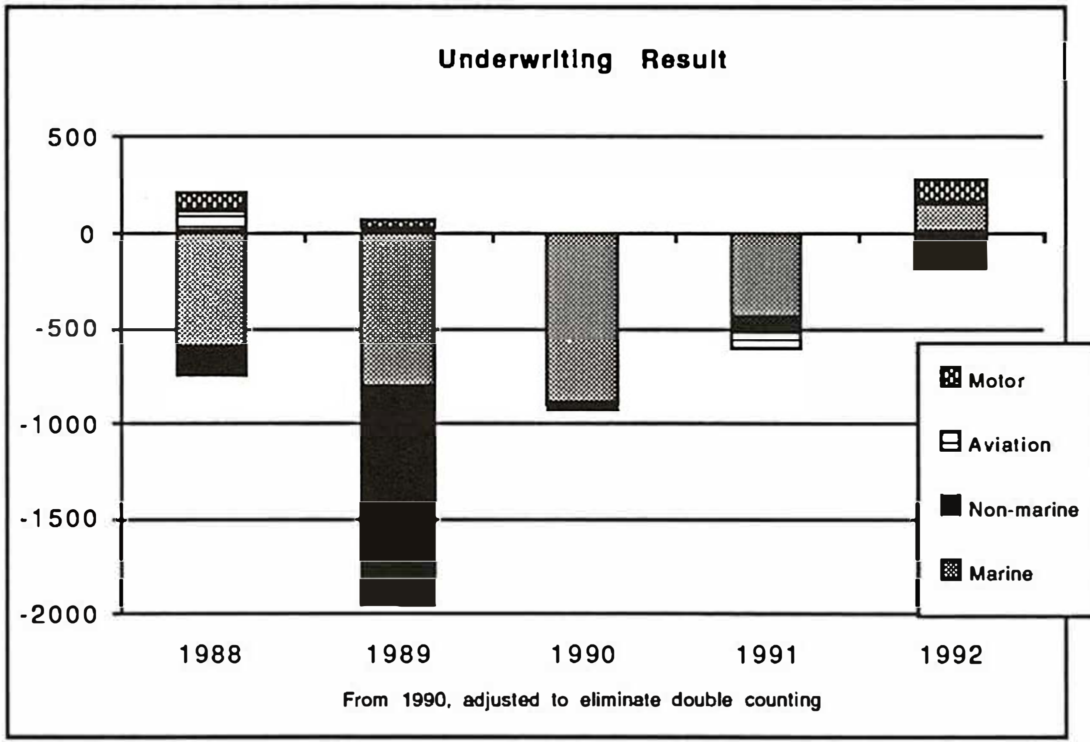
The "future market", which officially begins in 1996 but will, in practice, include the underwriting years of 1993, 1994 and 1995, is protected from any problems which may emerge in Equitas by the basis on which Equitas is being set up. Although the Central Fund must be rebuilt, it is also free of the liabilities from the past.

The situation will be different if reconstruction fails and Equitas is not put in place. A failure to solve the current problems facing Lloyd's may result in a steady or even precipitous drop in membership which could result in continuing trading no longer being viable. Lloyd's would then go into run-off and few run-offs are without problems. For Lloyd's, a final run-off would be complicated by the outstanding litigation, the long term nature of many of the liabilities and its unique structure.

The very existence of Lloyd's therefore, after more than three hundred years of operation, may well be decided by the success achieved in the reconstruction now under way.



Source: Lloyd's Global Results, 1990 to 1994



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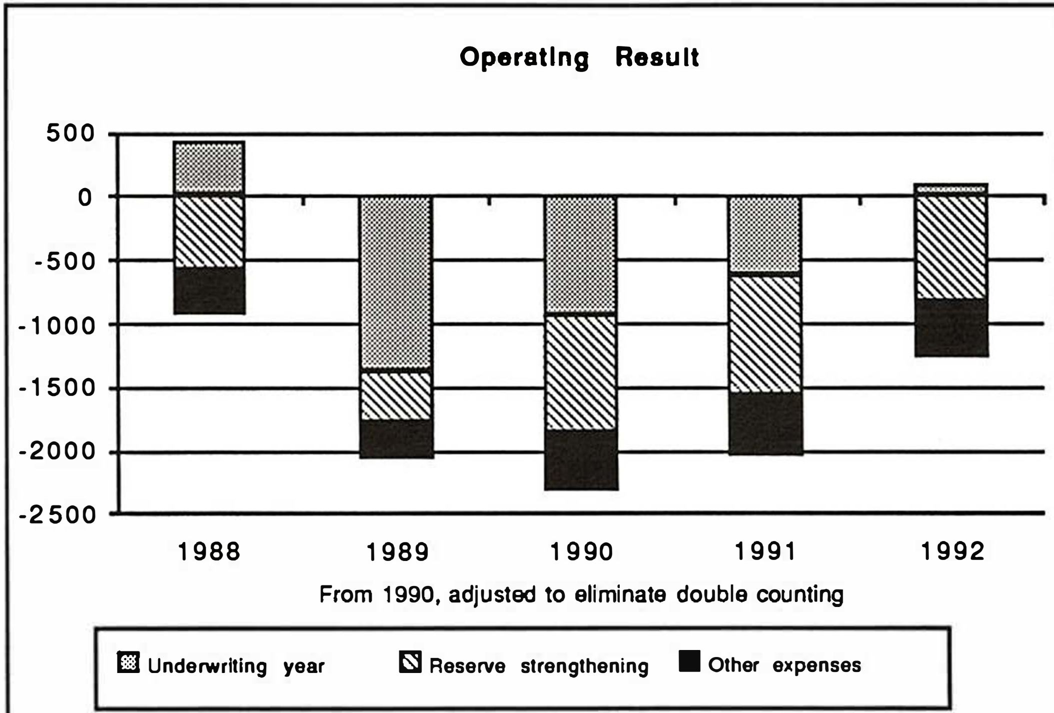

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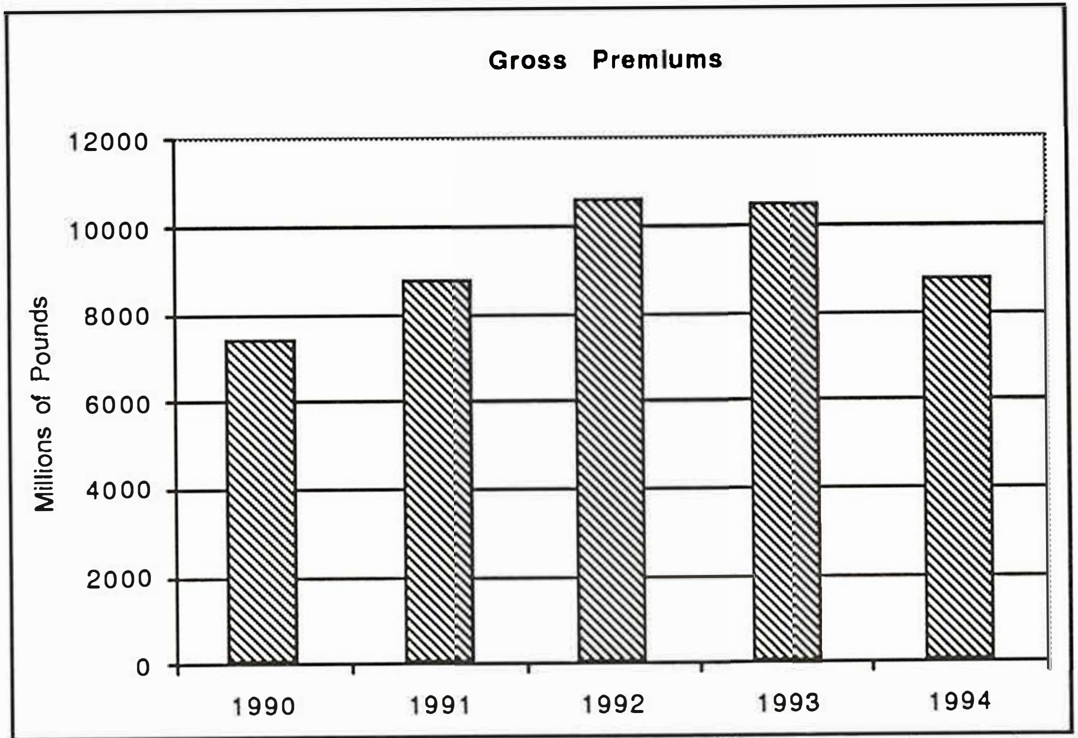

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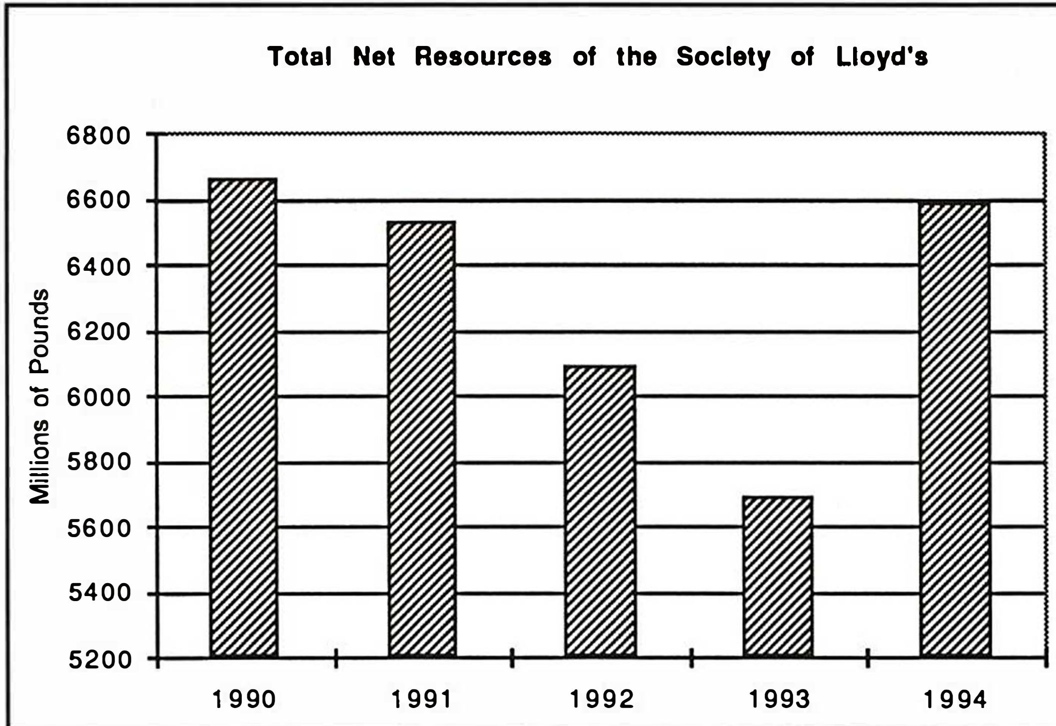

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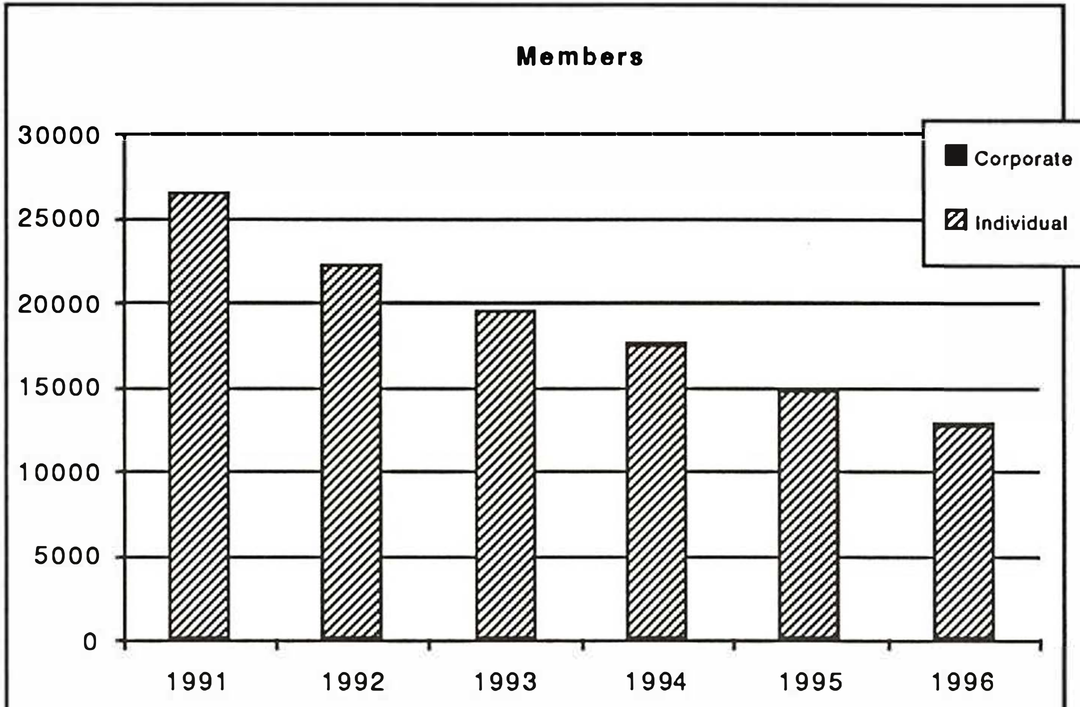

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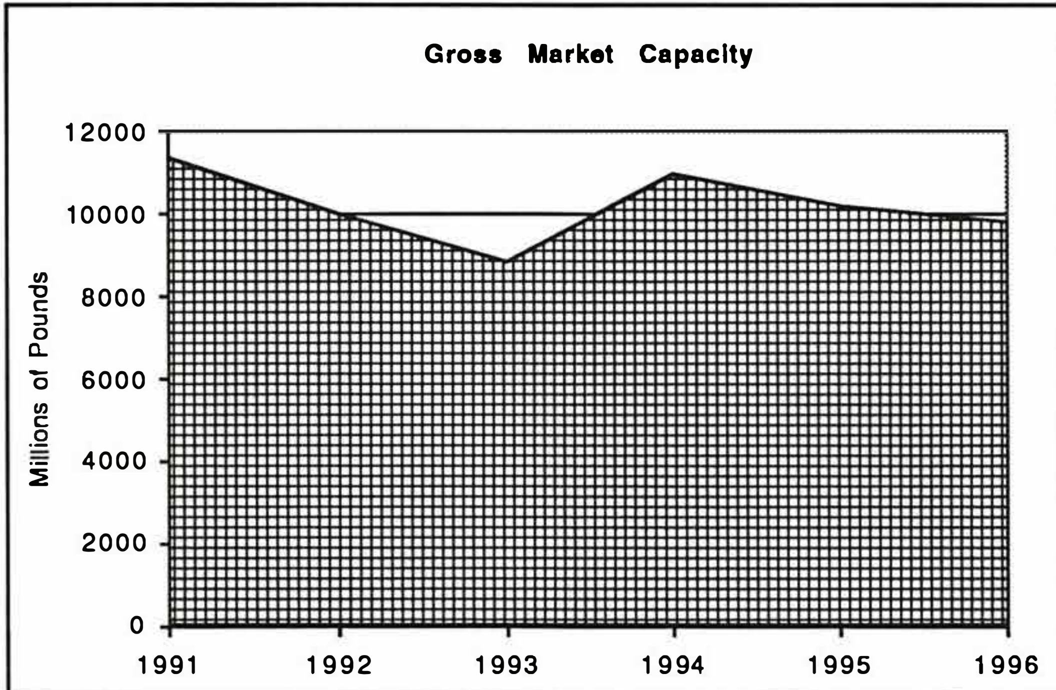

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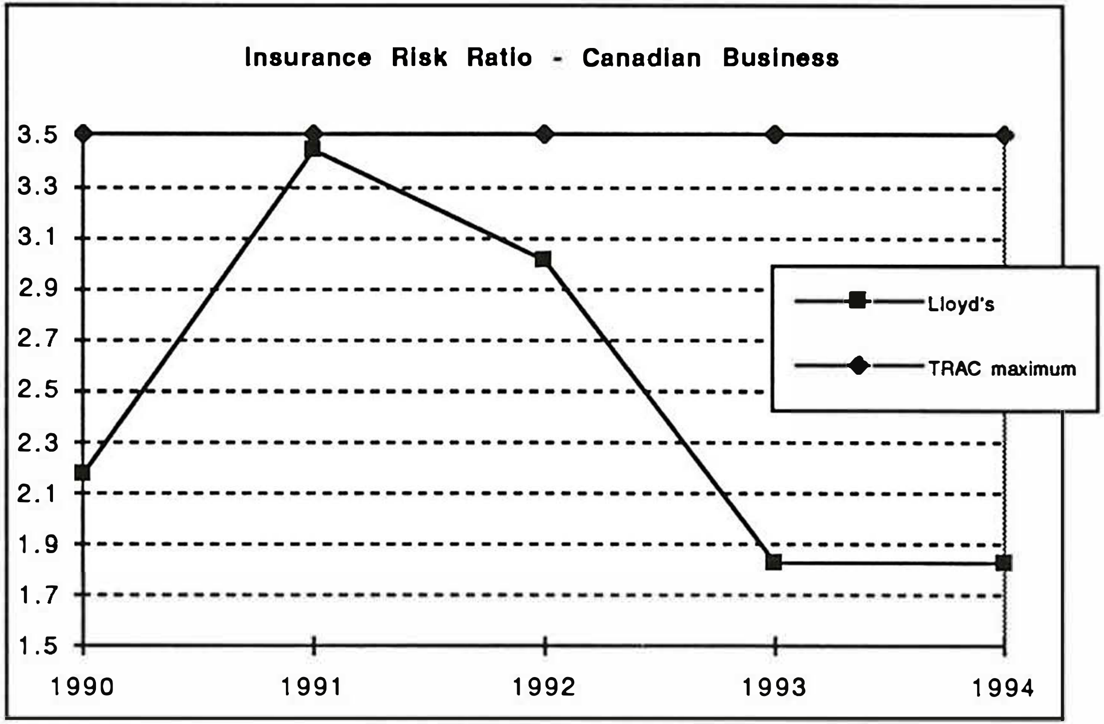

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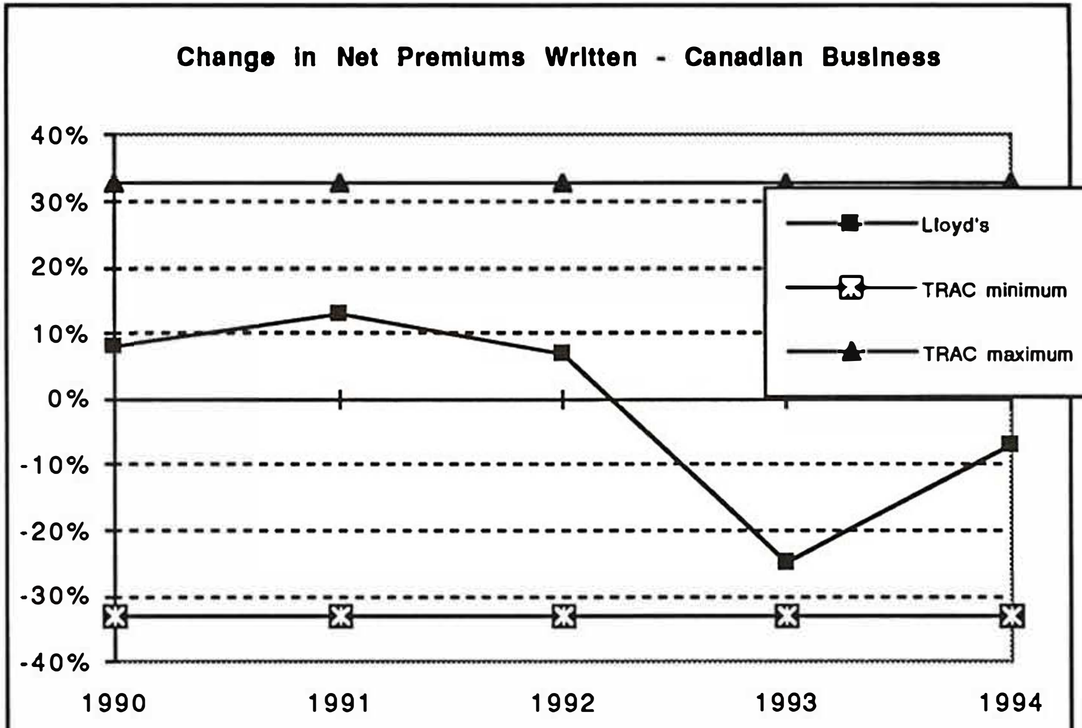

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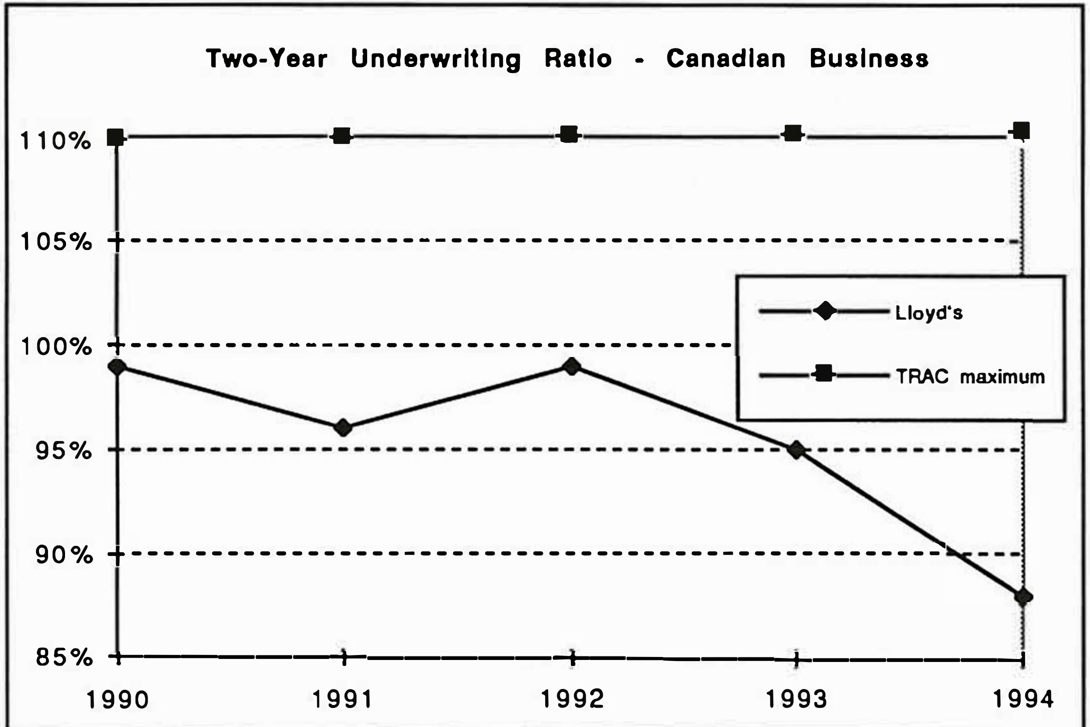

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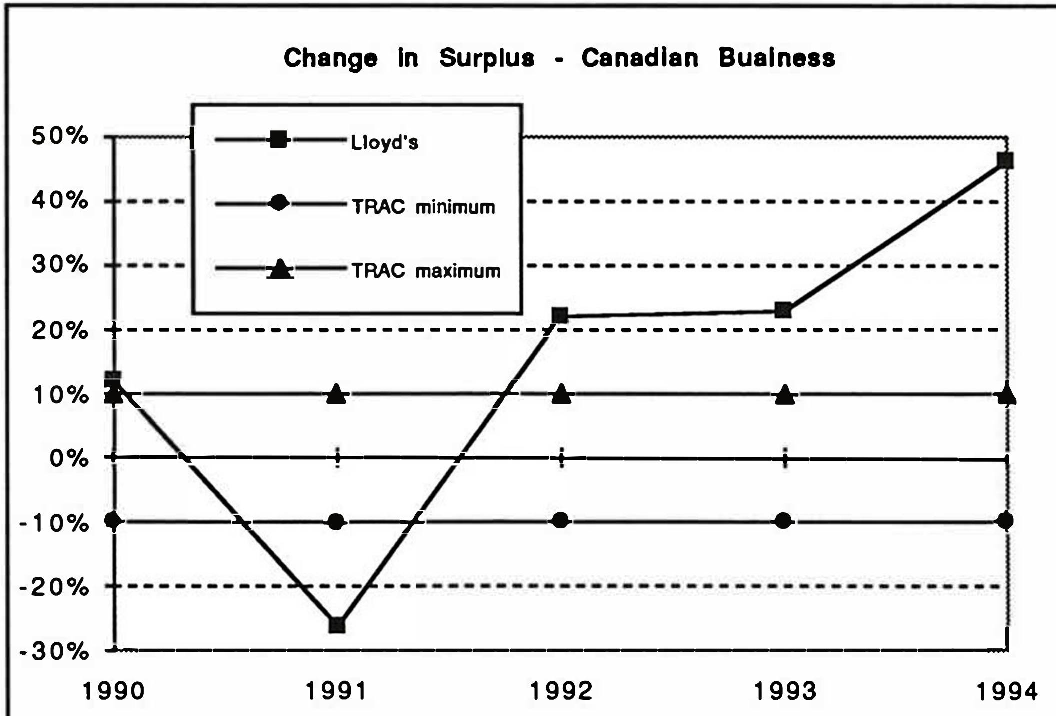

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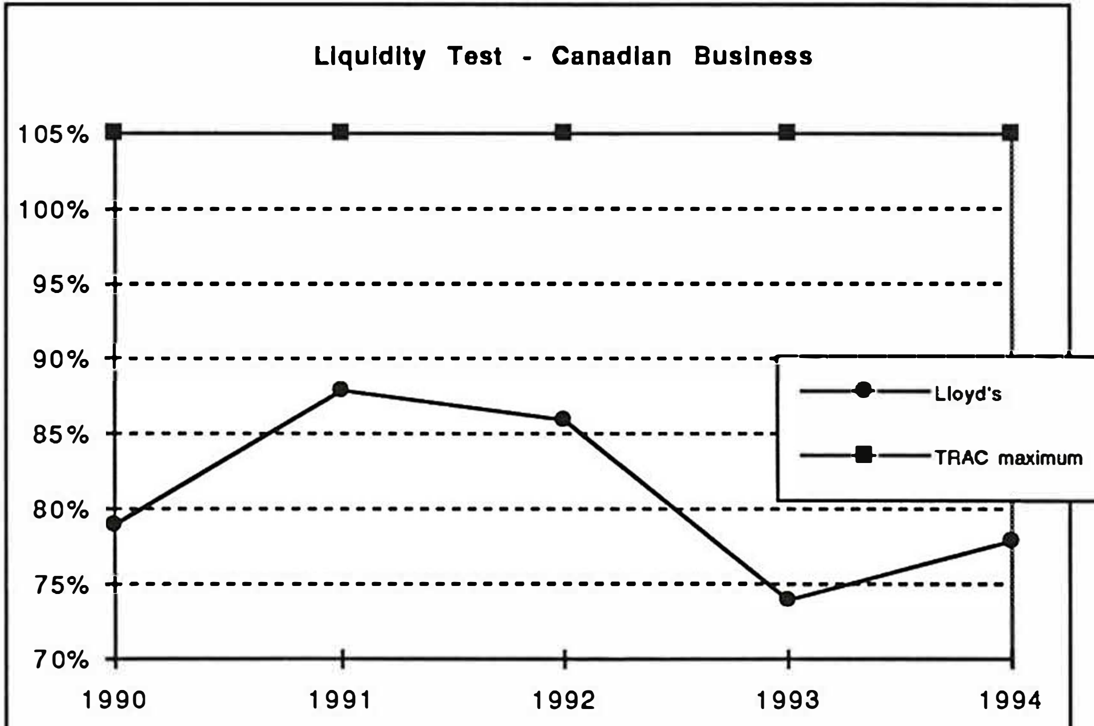

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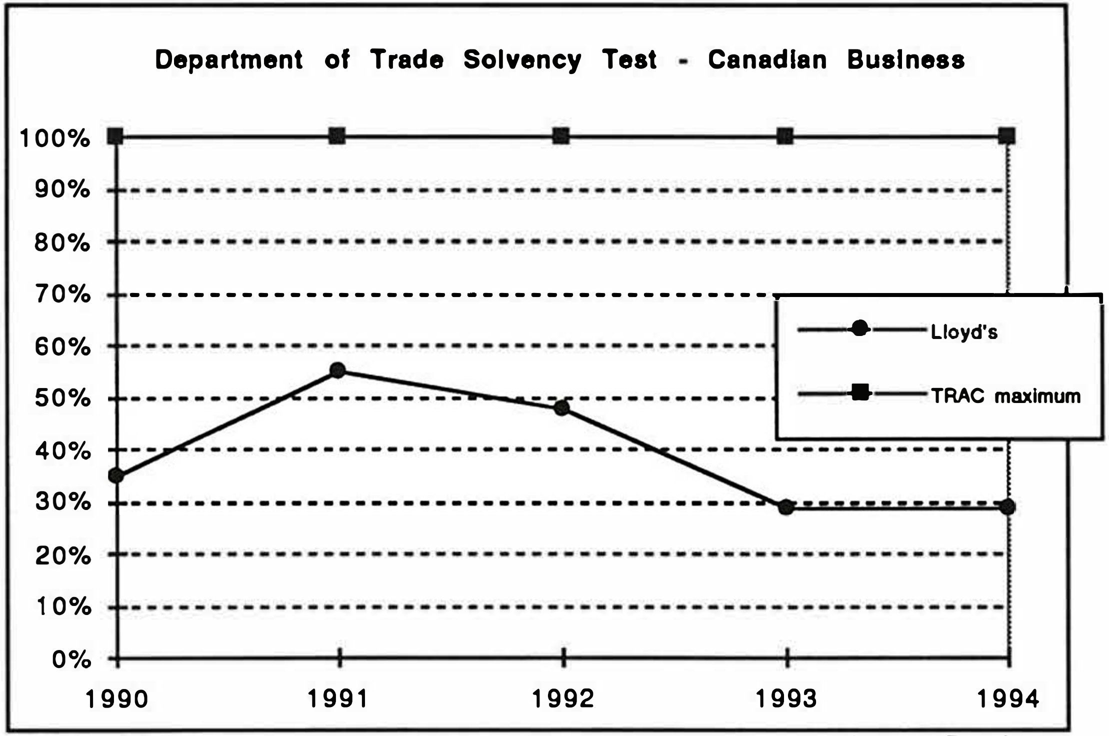

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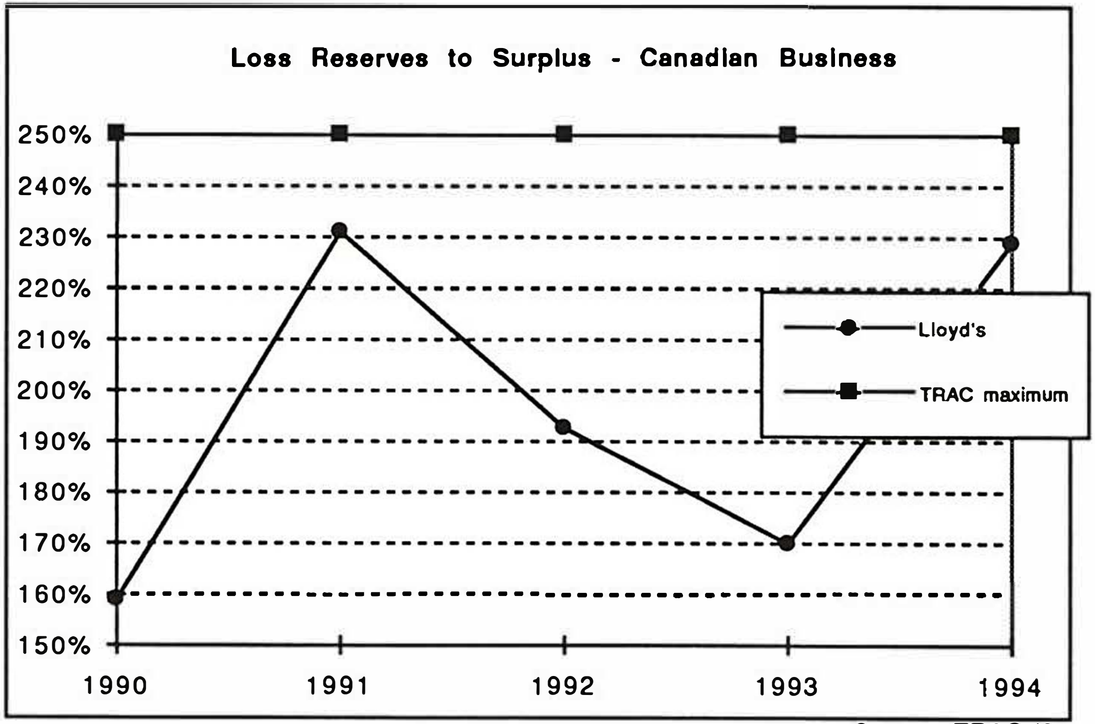

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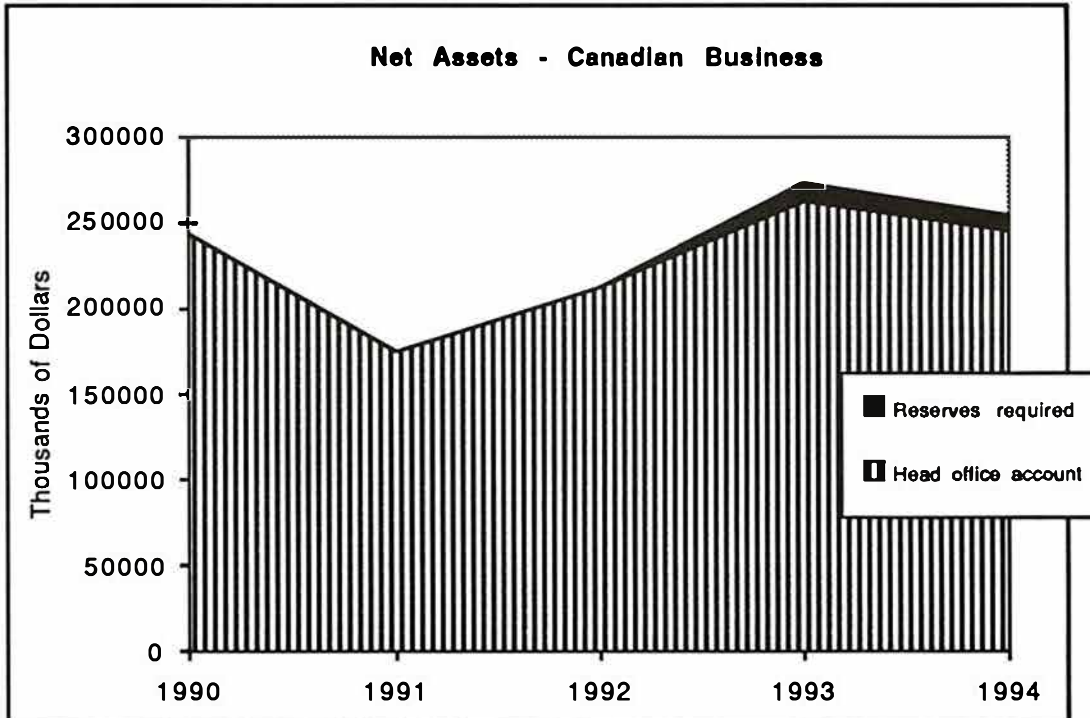

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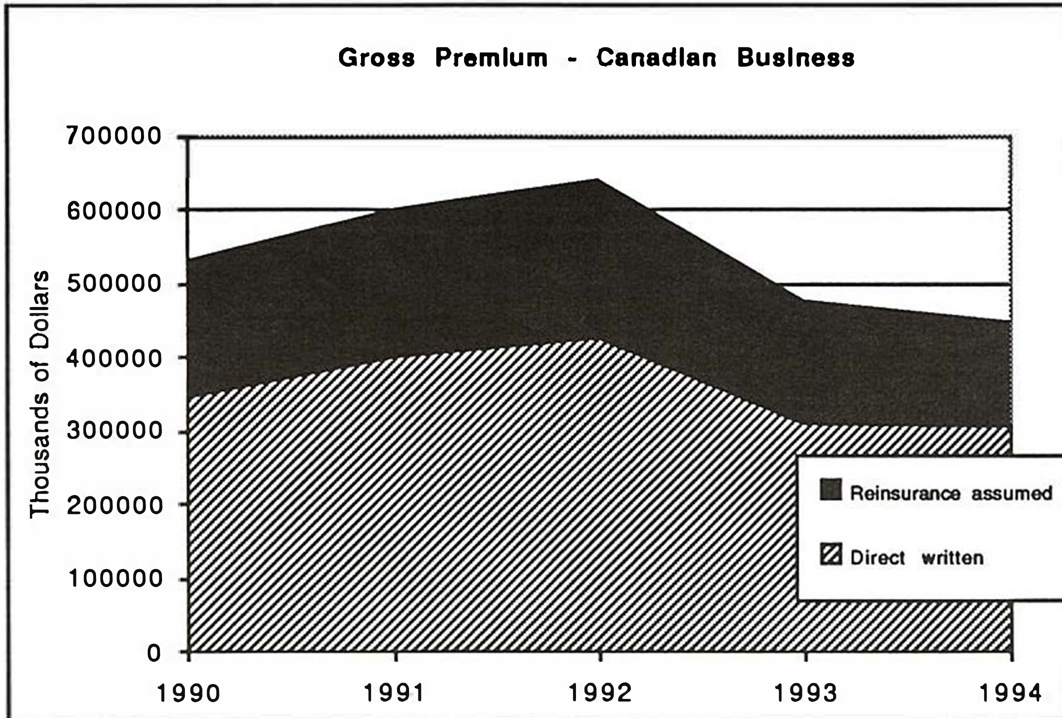

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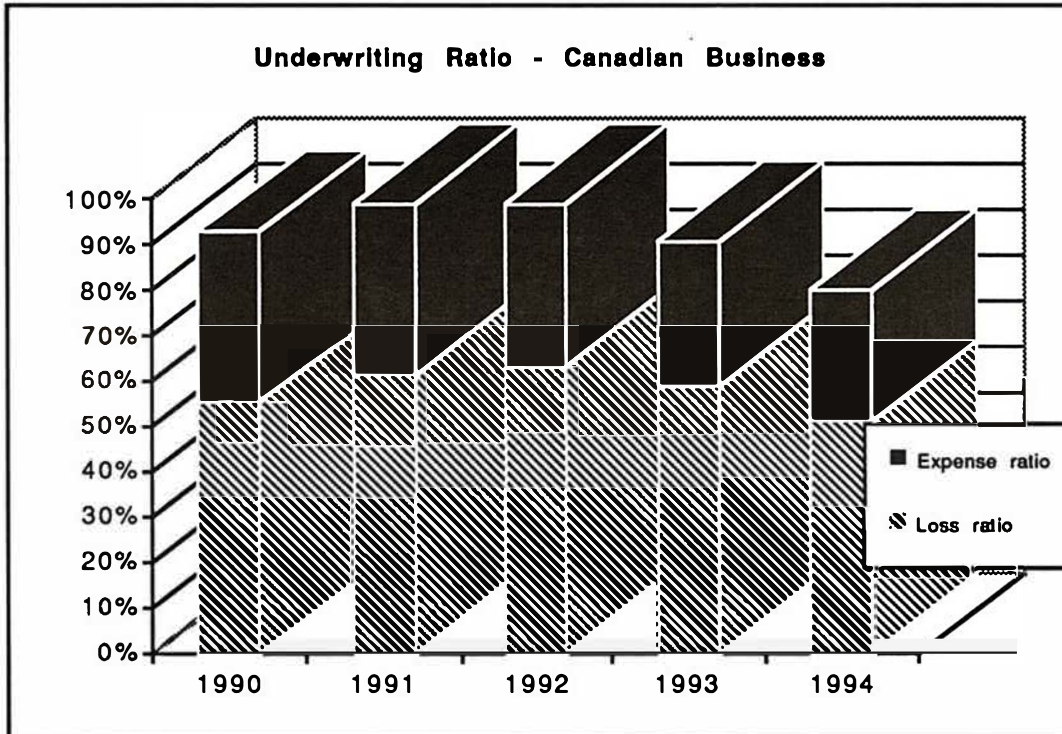

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