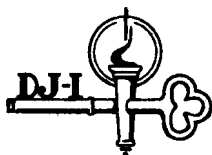


LLOYD'S OF LONDON

A PORTRAIT HUGH COCKERELL



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PREFACE

This book is an attempt to describe the institution of Lloyd's and its operation. It is not primarily a history, though it does contain a good many facts about the past because it is impossible to understand the workings of Lloyd's today without knowing how it has evolved over nearly 300 years.

Previous writers on Lloyd's have nearly always been members of the Lloyd's community. They have each had the advantage of an insider's knowledge and of the strong loyalty that membership of the community has always engendered. They have produced, as it were, self-portraits whereas I have taken a look at Lloyd's from outside as a disinterested spectator. One problem faced by all portrait painters is that the sitter will not keep still. Certainly Lloyd's has not kept still during the past year. It has hardly been possible to open a newspaper without reading of some new development at Lloyd's and much of the news has been distinctly unflattering. Much litigation and many enquiries are afoot, the results of which will not be known for months or even years. Besides this, the new Council of Lloyd's, constituted under the Lloyd's Act 1982, is only beginning to introduce new regulations and reforms. It could be said, indeed it has been said to me, that the time is not yet ripe for a new book about Lloyd's.

I respectfully differ. In my opinion it is a pity that no comprehensive description of Lloyd's institutions and practice has been available since C. E. Golding and D. King-Page's book *Lloyd's*, was allowed to go out of print some twenty years ago. It is true that there are excellent books available on aspects of Lloyd's. I need mention only the books of D. E. W. Gibb, Antony Brown, and Raymond Flower and Michael Wynne-Jones, which provide respectively an exposition of Lloyd's philosophy, a vivid

impression of its operation, and an illustrated history. This book has a more practical purpose – to help the reader to identify the various organisations that make up the Lloyd's operation to see how they mesh together. The time is over-ripe for such a book, even though some of the Lloyd's machinery is due for, and is receiving, an overhaul. The state of affairs described is that prevailing early in 1983.

In painting on a wide canvas I may have got some details wrong. I shall be grateful for a note of any corrections for the benefit of a future edition.

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ILLUSTRATIONS

Between pages 34 and 35

- The exterior of Lloyd's Coffee House, 1808.
- A caricature of the Coffee Room at the Royal Exchange, 1798.
- The 1838 fire that destroyed the first Royal Exchange.
- The new Royal Exchange, rebuilt in 1844.
- The Lloyd's building in Lime Street, opened in 1957.
- The new Lloyd's building presently under construction.

Between pages 66 and 67

- The Underwriting Room in Napoleonic times.
- A gambling policy on the life or arrest of Napoleon.
- The Underwriting Room in mid-Victorian times.
- Walter Farrant, a famous Victorian caller.
- Lloyd's Underwriting Room after the loss of the *Titanic*.
- The Underwriting Room, caricatured by H. M. Bateman.
- Lloyd's Underwriting Room in 1949.
- The Underwriting Room in Lime Street.

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- The caller's rostrum.
- The Lutine Bell.
- The *Hindenburg* in flames.
- The *Orion* oil-rig being towed.
- Lloyd's old and new forms of marine policy.
- The front page of *Lloyd's List*, from 1740 and 1983.

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Henry Montague Hozier.

Cuthbert Eden Heath.

Peter North Miller, Chairman of Lloyd's 1984.

Ian Hay Davidson, Chief Executive of Lloyd's.

The Committee of Lloyd's in session.

Henry Cooper, a member of Lloyd's, at the Wharncliffe meeting in 1980.

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LLOYD'S OF LONDON TODAY

Lloyd's of London is tucked away in a side street. The stranger may not penetrate its portals without an introduction. Armed with one he can enter a large hall where 1 per cent of the world's insurances are transacted. This is a busy market place and one's first impression is confused. There are thousands of people. After a while it becomes clear that there are hundreds of desks, large and small, at the head or foot of which a varying number of people, from three or four upwards to twenty or so, are sitting on upright benches. The desks are arranged in long straight aisles along which people move. From time to time one of these people stops to speak to a man seated at a table and shows him a document. Some words ensue. Then often the seated man will scribble something on the document, apply a rubber stamp, make a note in a book on the desk, and give the document back. The other man walks off and goes to another desk, like a bee in search of honey, where the process with the document will be repeated. At some places there are people queuing up to speak to one of the seated men. The conversations, whatever they are, do not last long. On one side of the room, on a rostrum, is a man in a red robe who keeps up a chant of the names of people who are wanted on the telephone. Numbers light up on large screens like scoreboards at either side of the rostrum. Elsewhere there are notice boards with messages and sheaves of coloured slips attached to them. The doors are guarded by officials in red robes who are evidently there to keep out intruders. It is clear that something is going on, but what?

The Stock Exchange, which has a viewing gallery for the public, is easier to understand. There, the dealers, called jobbers, sit or stand at their pitches where a price list of the securities they deal in is displayed. They are approached by stockbrokers to buy or sell securities. Their price

lists are always being marked up with changes, in blue if the price goes up, in red if it falls. The outsider can judge more or less what the trend of the market is. Transactions are said to take place on the 'floor' of the exchange.

At Lloyd's there are no price lists and it is impossible to detect a trend except to notice that the level of activity varies according to the time of day.

The trading hall at Lloyd's is called the 'Room', a modest description for a hall 340 feet long. The man in the red robe is the caller. The men at tables are said to occupy boxes, from the box pews of Lloyd's original coffee house. The principal man at each box is known as an underwriter. Those seated by him include a deputy underwriter and others who perform subordinate functions. The underwriter is he who decides whether to accept an insurance offered to him, and if so how much of it and on what terms. The offer is made to him by an insurance broker who comes to him bearing particulars of the proposed transaction, set out in a formal way, with numerous abbreviations, on a document called the 'slip'. If the underwriter decides to accept the offer he initials the slip and marks it with some letters and a number and an indication of how much of the insurance he is accepting. He is called an underwriter because at one time he signed his name at the foot of the insurance policy, the document which expresses the insurance contract which will ultimately be issued.

Underwriting members

Outside Lloyd's, insurance is transacted by insurance companies with capital provided by shareholders whose liability under the companies' contracts is limited for each shareholder to the amount of capital that he or she has subscribed. Lloyd's proceeds on a different and older basis. It is not a limited company at all. Instead it is a society, or club, of some 20,000 individuals called underwriting members, or 'Name(s)'. Each underwriting member accepts unlimited liability for his share of any insurance accepted on his behalf in the Room. This liability arises only in respect of his share. He is not liable for the shares in an insurance of any other underwriting member, but for his own share he must answer with the whole of his fortune if necessary. The holder of a Lloyd's policy may find that thousands of underwriting members have accepted a fraction of his total insurance. He is insured *at* Lloyd's by these underwriting members individually, but not *with* Lloyd's. It is true that there is a Society, or Corporation, of Lloyd's made up of all the underwriting members, but this corporation does not itself effect any insurance. It simply runs the market place and performs various services for the members. If a claim arises under a Lloyd's policy the policyholder must look for his money to the particular underwriters concerned in his policy.

Underwriting syndicates

The 20,000-odd underwriting members are like the shareholders of a company in that they provide the capital on the strength of which insurance is written at Lloyd's. They obviously cannot all themselves attend Lloyd's and decide which insurances to accept. This function is performed for them by a professional, called an active underwriter, to whom certain underwriting members have delegated power to act on their behalf. Those who do so form a syndicate which may consist of anything from two members to 3,000 or more. So when an active underwriter initials a slip he does so on behalf of the members of the syndicate of which he may or may not be himself a member, though he usually is. A syndicate differs from a partnership in that a partner is responsible for all the debts of the partnership whereas in a syndicate each member accepts liability for only his stated share of the syndicate's business. He receives his stated proportion of the premium due to the syndicate and is liable for the same proportion only of any claim. For an insurance of any size a number of syndicates are likely to share in the risk, so that hundreds or even thousands of underwriting members will be involved, each for a tiny fraction of the insurance in question.

There are over 400 underwriting syndicates at Lloyd's, classified according to the class of business they transact into marine, non-marine, aviation, motor and life. An underwriting member, in order to spread his risk, usually joins three or four syndicates. Each box at Lloyd's bears its syndicate number. Boxes are grouped according to the class of business transacted.

The active underwriter of each syndicate is the key man. It is he who decides on behalf of his syndicate how much of a given insurance to accept, at what rate of premium, and subject to what conditions. His actions govern the underwriting fortunes of the members of his syndicate, who by convention do not question his judgement or seek to influence his underwriting decisions. The remedy for any underwriting member who is dissatisfied is to leave the syndicate at the end of the year for which it is formed, as syndicates are reconstituted annually.

Lloyd's brokers

Underwriters are entirely dependent on insurance brokers for their flow of business. Only those insurance brokers who are approved by Lloyd's have entry to the Room. About 270 firms are so approved. They vary in size from the one or two-man concern to very large companies with thousands of employees in the United Kingdom and a network of offices or associated concerns overseas. These 270 firms are called Lloyd's brokers and can show with their address on their writing paper the

magic words 'and at Lloyd's'. A non-Lloyd's broker might put such a phrase as 'Insurance arranged at Lloyd's', but he has to act through a Lloyd's broker. (There are special arrangements for motor insurance, as described in Chapter 8.)

Insurance brokers differ from other kinds of insurance agents in that a broker acts on behalf of his client who wishes to place an insurance whereas an insurance agent outside the Lloyd's system acts on behalf of the insurance company in getting business. By the custom of Lloyd's the broker accepts liability to the underwriter for the premium payable on any insurance placed at Lloyd's and the underwriter can if necessary sue him for payment, which he must make even if for any reason he finds that he cannot recover the premium from his client. Claims are notified through the broker to the underwriter and the underwriter will settle them in his account with the broker. The client has, however, the right to sue the underwriter direct for payment of a claim or for any return of premium that may become due to him under a policy, as when, say, an insured ship is laid up for part of the term of insurance.

When a Lloyd's broker receives an enquiry for an insurance he must find out from his client all the material facts that a prudent underwriter would require to know when considering whether to grant an insurance and if so on what terms. A proposer is under a legal duty to disclose all material facts to an underwriter because insurance contracts are a class of contract that requires both parties to exercise the utmost good faith towards each other. The reasoning is that the proposer knows all about the risk whereas the insurer knows nothing. It is only just that the insurer should be put in possession of the requisite information.

The broker puts the material facts on a slip for the underwriter to see and goes into the Room in search of suitable underwriters. He will first approach someone who he thinks will be willing to 'lead' the slip, that is, to take the first slice (called a 'line') of cover. According to the nature of the business offered he will decide whom to approach. Some active underwriters, by reason of their knowledge and experience of a particular type of insurance, will acquire a reputation as potential leading underwriters for that class. Others, who may well know less about it, will be content to follow their lead and accept a line of the insurance offered. If the broker considers the rate quoted by the first underwriter he approaches is too high, he will seek alternative quotations from others. Once he has settled a rate with a leading underwriter he will have to go from one underwriting box to another until the slip is fully subscribed. When this is done he closes the transaction and prepares a policy which is submitted to the Lloyd's Policy Signing Office. There the policy wording is checked against the slip. If found in order the policy will be signed. The policy quotes the official numbers of the syndicates concerned in it and refers to a list of syndicates which states the shares in

each syndicate of each underwriting member. Lloyd's Policy Signing Office will also notify the underwriters of the transaction for both statistical and accounting purposes. There is a central accounting system which takes care of all the transactions between underwriters and brokers. This will be described in greater detail in Chapter 10.

The slip procedure has to be repeated whenever there is a modification to an insurance in the course of its term or on renewal. For some transactions the procedure can be too cumbersome and various devices are used. By way of example, it may be agreed in advance that modifications need only the approval of the leading underwriter. Again, brokers may be authorised to write business of a defined class, such as household insurances, on the underwriter's behalf and subject to his guidelines. Alternatively in, say, marine cargo insurance, an open policy may be issued under which all shipments of cargo are covered, provided they are declared monthly to the brokers.

The underwriter's aim is to get the highest premium he can for the risk he runs. The broker, on the other hand, owes it to his client to get insurance on the most favourable terms possible. Between the seller and the buyer of insurance there is thus a conflict of interest such as exists between buyers and sellers in any market. The theorist might expect that there would therefore be a complete separation between underwriting and broking, but this has not been the case for centuries. Many Lloyd's brokers are underwriting members and many underwriters are directors of broking concerns.

Underwriting agents

In addition Lloyd's brokers often operate as underwriting agents. Underwriting agents may exercise one of two functions or both simultaneously. The first function is to find persons willing to become underwriting members of Lloyd's and to manage such persons' affairs. Such management includes submitting proposals for election, finding underwriting syndicates for the member to join, watching the syndicates' progress and the member's investments, and keeping his accounts. An agency that performs only this function is known as a members' agency. Brokers are well fitted to undertake this work, as their clients include many potential underwriting members and conflicts of interest can hardly arise. The second function is that of managing the underwriting syndicates. The work includes finding members to join, providing office facilities, choosing the underwriting staff and appointing the active underwriter, who is thus heavily dependent on the broker concerned (if a broker controls the managing agency) for his career. There is in principle the danger that the broker could lean on the underwriter to accept business that he would rather reject in the interest of his

syndicate, or to take business at a cut rate to help the broker stave off competition from other brokers. Many underwriters say that this danger is more apparent than real and that they do not in practice favour the brokers who manage their syndicate, but to set any doubts at rest the Lloyd's Act 1982 provides that within a certain period insurance brokers shall divest themselves of the control of managing agencies.

To sum up what has been described, we have some 20,000 underwriting members of Lloyd's, who group and regroup themselves into over 400 underwriting syndicates, each with an active underwriter in charge who accepts insurances on behalf of the members of his syndicate. Every underwriting member binds himself to accept liability for a fraction of every insurance written by the syndicate 'each for himself and not one for another'. For that fraction his liability is unlimited. The business is marketed and serviced by 270 Lloyd's brokers, varying in size from the very large to the very small. Lloyd's is a market place for insurance which arrives there from all quarters of the world. Clearly the market needs an organisation to run it.

The Society (or Corporation) of Lloyd's

The organisation in question is the Society of Lloyd's, which was first incorporated by Lloyd's Act 1871. Its affairs have been conducted by the Committee of Lloyd's, consisting of sixteen persons elected by the members of Lloyd's, with a Chairman and two Deputy Chairmen. By virtue of Lloyd's Act 1982 the Committee has since 1 January 1983 been topped by a Council whose constitution is described in Chapter 9. Its functions are many. It admits members, approves Lloyd's brokers and underwriting agents, and exercises supervision over their activities. The Society also provides the market place and facilities needed for the transaction of insurance. These facilities include, for example, the maintenance of property, the provision of catering, the running of the Room, supplying intelligence and centralised policy-signing, accounting and statistical services. An important task is that of ensuring that as far as possible underwriting members should always be financially able to meet their commitments. Members are required to demonstrate that they have adequate financial resources and to make deposits as security. The premium income of each member is regulated in the light of his means and the extent of his deposits. Members also contribute to a central reserve fund held by Lloyd's which is kept available to meet the claims of policyholders if any member should default. The accounts of underwriters are subjected to close scrutiny ('the Audit') by independent accountants approved by the Society to ensure that the underwriters continue solvent and do not exceed the premium income they are permitted. The accountants report to the Society.

The Society also collects and publishes details of Lloyd's premium income and obtains certificates of solvency. The Department of Trade and Industry relies on the Society to monitor the solvency of Lloyd's underwriters, who are excused from making the detailed returns to the Department that are required of insurance companies.

All countries have legislation controlling insurance companies. The Society of Lloyd's has a department which monitors such legislation and where necessary makes special arrangements, so that Lloyd's underwriters are able to transact insurance emanating from the country concerned. In Canada and the USA, for example, premiums collected have to be paid into special trust funds that are held for the payment of claims from policyholders in those countries. Again, business in France has to be separately recorded. The Society assumes responsibility for ensuring that these arrangements are honoured.

Another service rendered by the Society is the provision of central claims-settling facilities through the Lloyd's Underwriters' Claims and Recoveries Organisation (LUCRO). The work of the central services will be more fully described in Chapter 10. The Society of Lloyd's has nearly 2,000 people in its service.

The underwriters in the various markets have formed associations of their own for technical purposes which operate under the umbrella of the Committee.

Lloyd's brokers used to have their own market association, which has now become, as the Lloyd's Insurance Brokers' Committee, a part of the British Insurance Brokers' Association, but which remains answerable to the Council of Lloyd's in Lloyd's matters. There is also a Lloyd's Underwriting Agents' Association.

Lloyd's share of the market

Until a century ago Lloyd's was primarily a centre for marine insurance. It remains dominant in this field, but nowadays has more non-marine insurance premium income than marine. Examples of non-marine business are fire and liability insurance. If we compare the business placed at Lloyd's with that transacted by insurance companies we find that in marine insurance Lloyd's has more premium income than the companies. In life insurance Lloyd's has only a tiny share, as it confines itself to insurances that run for at most ten years. In other classes of insurance the insurance companies almost always have the lion's share. Many large insurances, for example, those on oil rigs, are shared between Lloyd's and the companies.

The Lloyd's system, in which hundreds of active underwriters are free to exercise their individual judgement, is particularly successful in coping with unusual or one-off risks. In the mass market large insurance

companies have the advantage of a branch network to cover the country. Thus, in motor insurance in the UK, the companies have four-fifths of the business.

Lloyd's flexibility has enabled it to penetrate the North American market to such an extent that over half its business comes from the United States and Canada.

Lloyd's, past and present

Lloyd's, like many British institutions, is a curious mixture of ancient and modern. Nobody can hope to understand the present Lloyd's without some knowledge of how it has come to be what it is. Before going on to examine in greater detail its present mechanism we shall devote three chapters to describing how Lloyd's has evolved over the last three centuries. Meanwhile, four examples will illustrate how the past lives on in the present.

First, the attendants in blue coats at Lloyd's are known not as messengers or porters, but as waiters, a reminder of the coffee house which was all Lloyd's was for its first century of life.

Secondly, entries in the loss book kept in the Room, which records ship sinkings and other disasters, are entered with a quill pen in copper-plate handwriting.

Third, the form of Lloyd's marine policy until 1982 had remained substantially unchanged since an example of it was appended to an Act of Parliament in 1779. Most of the wording was even earlier in date. Only now is the marine insurance world modifying its ancient and in some respects meaningless wording.

The fourth example concerns a feature of the Room, the Lutine Bell, which hangs above the caller's rostrum. It is a ship's bell from the *Lutine*, a French frigate surrendered to the British in 1793, which became a British warship and served under Nelson in the Mediterranean. In 1799 on a journey carrying bullion to Hamburg, it struck the sands at the mouth of the Zuider Zee and sank. Underwriters paid for the bullion. A little was salvaged in 1801 and in the course of a further attempt in 1859 the ship's bell, weighing 80 pounds, was recovered and came to Lloyd's. At one time a single stroke was given to signal the loss of a ship. On rare occasions nowadays it is struck once for bad news and twice for good as, for example, when Prince William was born in 1982.