EIR Economics

Hoary old Lloyds of London heads into insolvency

by William Engdahl

A major cash crisis faces the world's oldest and largest insurance market, the 308-year-old Lloyds of London. According to analysts in the international insurance market in London and Switzerland with whom *EIR* has spoken in recent days, if Lloyds is not able to come up with as much as perhaps $4.8 billion in new cash by the deadline of their annual asset review by Britain's Department of Trade and Industry in three months, the group could be forced to declare bankruptcy, a shock wave some believe would rock the very foundations of the entire City of London financial center, and reverberate around the globe. At present, Lloyds is responsible for a staggering 48% of all international reinsurance volume done in the London market, itself one of the world's largest insurance markets. Lloyds alone takes in premium income of $16 billion annually. Almost two-thirds of Lloyds's business is in North American insurance underwriting.

If the needed cash is not raised by the August audit, Lloyds by law will be barred from writing new business, the entire business will be closed, and some 60,000 employees linked to Lloyds will be out of work. Coming in the wake of the spectacular Barings Bank collapse in March, and problems with S.G. Warburg, one of the leading merchant banks of the City of London, the effect on the credibility of the City of London as a world financial center would be devastating.

Lloyds is one of the core institutions of the City of London financial center, the heart of what has been termed the Club of the Isles, the immensely influential pooling of political and financial power of the circles around the House of Windsor and their financial and industrial allies. Like the City of London banking and other financial domains, Lloyds and the insurance sector are also largely unregulated. This is in stark contrast to Swiss, German, and other conservative continental European financial markets. Margaret Thatcher's political base during her 12 years in office was the power of this City of London establishment, and their generous financial contributions financed her Tory Party campaigns.

Whether or not an emergency behind-the-scenes rescue from the Bank of England and U.K. banks can forestall bankruptcy a while longer, one of the world's major financial groups, and the one with the most intimate ties to the highest levels of the British and European aristocratic families, is in a life-and-death struggle.

The solvency test

Under British law, U.K. insurance companies must be audited each year by the British Department of Trade and Industry (DTI) to determine if they have the assets to continue writing insurance. In August, Lloyds will face its annual audit. Last year, Lloyds admits, it "just barely passed the test." This year, according to the London *Independent on Sunday,* one senior DTI civil servant has acknowledged, in a letter to a Lloyds "Name," his personal doubt that it will pass.

The DTI test involves two categories. The first is considered little problem. It takes the aggregate assets of all 33,000 Lloyds "Names," the wealthy individuals who make up Lloyds's unique capital base, and balances them against aggregate liabilities. These Names, as they are known in Lloyds's unique parlance, include some of the world's wealthiest persons, most notably from among the highest levels of the British aristocracy and royalty: for example, Prince and Princess Michael of Kent, the Duke of Norfolk, Lord Alexander, Henry Kissinger's intimate friend Lord Weidenfeld, and Rupert Hambro of the old City banking family. It is believed there are still enough highly wealthy Names to give the aggregate asset-liability account a positive balance.

The problem for Lloyds falls in the domain of the second

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solvency test. Here, each of the 33,000 Names, who are incorporated as 33,000 separate legal entities, must show their own solvency. If any single Name is insolvent, the Central Fund of Lloyds of London must show that it is able to cover that Name's liabilities in full. Here is where problems come in for Lloyds.

On May 1, the chairman of the Council of Lloyds of London, David Rowland, revealed that the vital Reserve Fund, which must cover losses of individual Names in its syndicates, was unable to cover a $1.7 billion deficit, as of Dec. 31, 1994. Five years of previous forced payouts had depleted its resources. The deficit of $1.7 billion reportedly came from some 9,000 of the 33,000 Names worldwide, who have either refused or were financially unable to honor their commitments to Lloyds. Either Lloyds comes up with those funds by August, or the company fails the DTI test and is no longer able to write insurance. Knowledgeable insurance persons have told *EIR* that the most likely recourse for Lloyds to get the cash by August will be a new levy on active Names. But those Names have the right of veto, and many are likely to reject further levies. Some believe a Bank of England bailout may be the only recourse to avoid bankruptcy.

The Lloyds 'Names' system

Lloyds, perhaps the best-known insurance company in the world, is noted for its willingness to insure almost anything for a price. This includes a highly lucrative business insuring Ibero-American wealthy businessmen from kidnapping, a part of Lloyds's so-called "non-Marine" liabilities. According to a spokesman for Lloyds, such kidnap insurance in the past two years has been "one of the healthy growth areas of Lloyds syndicates in terms of premium income," with estimates of premium income in 1993 from this alone at some $1 billion or more.

Lloyds also insures ships and ship cargoes from loss-at-sea, its original business three centuries back. It has also moved to insure North Sea and other oil platforms, and office buildings against earthquake and hurricane damage, in addition to the normal risks of fire and accident insurance.

What makes Lloyds different is its relation to the Names. Lloyds is not an "insurance company," but rather an insurance market, something akin to a Chicago Mercantile Exchange of international insurance, with the Lloyds corporation acting as the "exchange" guarantor for member traders, the syndicates.

Originally, groups of very wealthy merchants met at Lloyds Coffee House in London beginning in 1687, and decided to pool their assets to cover risks to any English ship cargo at sea, adding their "name" to the group sharing the risk. Through this system, British merchant traders prospered and grew to dominate their continental European rivals in the 18th and 19th centuries. The system was only little modified over the years.

Today, any person who applies, if accepted by Lloyds, can become a Name, and join one of the hundreds of Names syndicates. Those syndicates have professional underwriters who have offices in the huge Lloyds headquarters on Lime Street in the City of London. The syndicate underwriter meets daily with dozens of Lloyds licensed "brokers" who ask the underwriter to insure a specific client risk somewhere in the world. The underwriter is the heart of the insurance and reinsurance market called Lloyds of London. His judgment is key to winning or losing. For two decades, until the end of the 1980s, Lloyds Names were not disappointed with most underwriters, because they got annual dividends in a kind of profit-sharing scheme from the underwriters of often 30-40% annually on invested capital.

But in the last five years, the entire system has begun to collapse. According to a member of a leading Zurich insurance group interviewed by *EIR*, "In recent years, Lloyds, in order to increase capital available, began to allow people to become Names who have no business taking this kind of personal risk." The previous very high wealth requirement to be eligible as a Name was lowered beginning in the early 1970s, in a desperate bid to raise new capital in face of big damage claims and growing competition from American, German, and Swiss insurance rivals. Today, anyone showing a total net worth of $160,000 can become a Name.

But, when an individual signs the contract to become a Name, he also signs a legally binding agreement to unlimited liability for claims that might be made against his syndicate. He is obliged to pledge his entire assets, including home, jewelry, furniture, stocks, bonds, and bank account, if needed, to back any new levy by his syndicate. Many new Names were lured in the 1980s by the prestige of being a "Lloyds Name," along with the elite titled aristocracy and such. They were often told it was a "sure win" deal, leading them to forget the fine print.

The beginning of the end

That began to change when legal claims against companies producing asbestos in the United States, by individuals and trade union groups alleging asbestosis lung disease, brought huge, unexpected claims against certain Lloyds syndicates. "Lloyds did something in its eagerness to get the fat premium payments from underwriting asbestosis risk in the United States during the 1970s and 1980s that no large continental European or U.S. insurer would have done," one source said. "They did the underwriting from their offices in Lloyds's London headquarters, with no direct on-the-ground presence inside the United States insurance market, with no one knowledgeable about U.S. court liability law and its complexities." In effect, Lloyds syndicates gambled heavily and lost.

One group of syndicates, run by Dick Outhwaite, was taken to British court in 1991 by 1,600 of its Names. Lloyds had written so-called "long-tail policies," in which its liability for future claims never dies. U.S. courts, beginning in

1985, began to make huge awards to victims of asbestosis. And under old policies, some going back to the 1940s, Lloyds syndicates had to pay most of those reinsurance bills for the asbestos manufacturers such as the now-bankrupt Johns Manville Co. As publicity of the huge court asbestos awards spread, more suits were filed, leading to snowballing claims, threatening the exposed Lloyds syndicates, and their Names, into the next century. By 1991, potential losses to the Outhwaite syndicates were believed to be as high as $2 billion, a potential average loss of $1.2 million for each of 1,600 Names in the syndicate. Because no fixed cap on liability could be made, no insurance company in the world would agree to cover it in the reinsurance market, leaving an open liability of the Name syndicates.

This was compounded by similar foolish and, in some cases fraudulent, insurance forays by individual Lloyds underwriters. Then, a series of unprecedented catastrophes hit the Lloyds market beginning in 1988, with Hurricane Andrew, the *Exxon Valdez,* the San Francisco earthquake, the North Sea Piper Alpha oil rig fire, and, most recently, the Kobe earthquake, which will cost Lloyds Names an estimated $2.4 billion in claim payouts alone.

Lloyds has an archaic system of settling three years back. Thus, final results presented on May 30 will be for the insured year 1992. By then, cumulative losses by the 33,000 Names will likely total a staggering $14 billion or more, according to Lloyds specialist analysts, Chatset. As claims on Names began to snowball after 1988, for an unprecedented five years running, Names began to face bankruptcy, and several reportedly committed suicide amid personal financial ruin. Today an estimated 9,000 Names are financially insolvent, partly reflecting the lowered wealth standard of recent years. Their arrears total alone more than $2 billion.

But even the figure of $14 billion in total losses likely understates the amount. According to estimates by one former Lloyds broker, David Springbrett, the real losses as of the Lloyds year 1991 were already above $20 billion, even before the expected $2.4 billion losses for 1992, which are expected to be announced at the May 30 Lloyds annual meeting.

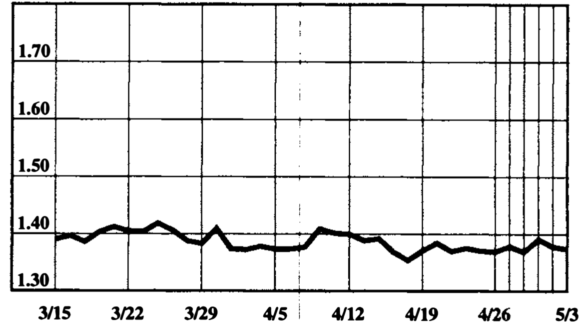
Thousands more Names, including many in the United States who, like Supreme Court Justice Stephen Breyer, were lured into becoming a Name without full awareness of potential liability, have stopped paying their syndicate, and instead are suing in U.S. or U.K. courts. Many of these are recent Names who claim they were deliberately steered to the most high-risk syndicates, to give needed capital, such as Outhwaite's, leaving the old established "wealthy Names" mostly safe in more conservative syndicates.

Because of the three-year lag on reporting results, the added losses to Lloyds owing to exposure to financial derivatives speculation, foreign currency losses, and such over the period beginning early 1994 during the shocks to world financial markets, can only be imagined.

Currency Rates

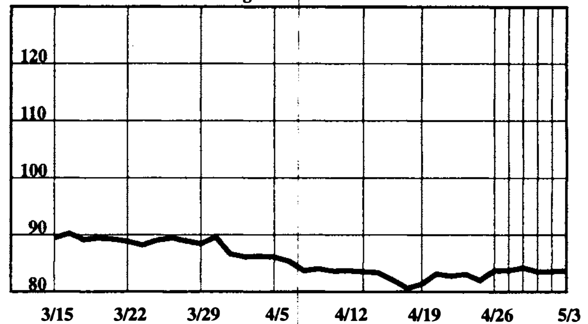
The dollar in deutschemarks

New York late afternoon fixing



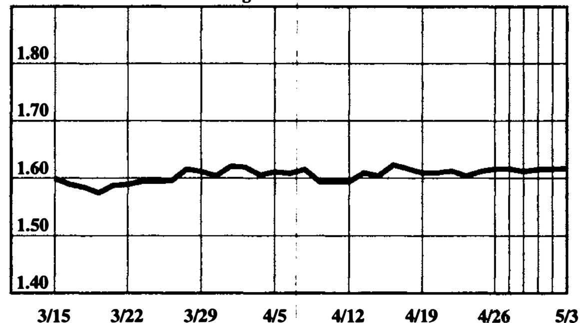
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing