

names working in the market decreased and that of external names increased in proportion as the syndicates became less profitable. There does not appear to have been any bias in the allocation of new capacity to LMX syndicates generally.

Table 5.17

**Average percentage of new capacity**

	<i>Directors of agents</i>	<i>Directors of brokers</i>	<i>Other working</i>	<i>Relations</i>	<i>External</i>
<b>1986 - 1988</b>					
Top 10	4.2	3.0	4.9	5.3	82.6
Top 20	4.6	3.4	4.9	5.6	81.5
Top 40	4.1	2.9	4.1	5.9	83.0
Market Average	3.6	2.9	3.7	6.1	83.7
Bottom 40	3.4	2.1	2.2	6.3	86.0
Bottom 20	3.2	1.4	1.5	6.1	87.8
Bottom 10	3.4	1.0	1.0	5.7	88.9
LMX	3.8	2.8	3.3	6.3	83.8
<b>1989 - 1991</b>					
Top 10	3.4	2.6	5.4	6.9	81.7
Top 20	3.9	2.6	4.3	6.0	83.2
Top 40	3.9	2.6	4.3	6.0	83.2
Market Average	3.5	2.1	3.3	6.0	85.1
Bottom 40	3.7	1.5	2.7	5.9	86.2
Bottom 20	3.7	1.1	1.8	6.1	87.3
Bottom 10	3.3	0.9	1.7	6.0	88.1
LMX	3.3	0.9	1.7	6.0	88.1

Top and Bottom syndicates have been defined on the basis of the average over the period 1983 to 1990 inclusive, with the returns for 1989 and 1990 being at the 2 and 1 year period respectively.

**Analysis by  
profitability**

5.18 For each of the years 1983 to 1991, an analysis has been made of the capacity and new capacity allocated to each of the five main categories of names in each of the five profit groups given in section para 5.6. We show in Tables 5.18 and 5.18a summaries of those analyses for new capacity and all capacity respectively for 1986 to 1988 combined and 1989 to 1991 combined. **The tables indicate that there is evidence that those names working in the market were on the more profitable syndicates and that over the period new capacity was allocated in such a way as to maintain that position.**

TABLE 5.18

Cumulative percentage of new capacity allocated to profit groups for each category of name

<i>Profit group</i>	<i>Directors of agents</i>	<i>Directors of brokers</i>	<i>Other working</i>	<i>Relations</i>	<i>External</i>
<b>1986-1988</b>					
1	11.9	11.5	11.6	10.5	10.9
2	37.3	39.8	39.8	34.7	33.6
3	88.8	91.6	91.9	87.7	87.6
4	95.1	95.9	96.8	95.1	95.4
5	100.0	100.0	100.0	100.0	100.0
<b>1989-1991</b>					
1	10.6	10.7	11.2	10.7	10.8
2	34.9	37.2	38.6	31.8	31.7
3	85.7	88.4	88.9	86.5	86.0
4	92.4	94.4	94.7	93.4	93.1
5	100.00	100.00	100.00	100.00	100.00

TABLE 5.18a

Cumulative percentage of capacity allocated to profit groups for each category of name

<i>Profit group</i>	<i>Directors of agents</i>	<i>Directors of brokers</i>	<i>Other working</i>	<i>Relations</i>	<i>External</i>
<b>1986-1988</b>					
1	10.2	8.7	9.2	9.4	9.8
2	34.6	35.5	34.6	32.2	31.4
3	89.0	90.8	90.2	87.7	87.3
4	95.6	95.9	96.5	95.3	95.3
5	100.0	100.0	100.0	100.0	100.0
<b>1989-1991</b>					
1	11.9	10.8	11.4	11.2	11.6
2	38.1	39.6	39.5	35.5	34.8
3	89.8	91.8	91.5	88.9	88.7
4	95.6	96.4	96.6	95.9	95.9
5	100.0	100.0	100.0	100.0	100.0

**Analysis by riskiness** 5.19 For each of the years 1983 to 1991, an analysis has been made of the capacity and new capacity allocated to each of the five main categories of names in each of the four riskiness groups given in para 5.9. In addition it must be remembered that certain syndicates could not be allocated a riskiness coefficient. We show in Tables 5.19 and 5.19a summaries of those analyses for new capacity and all capacity respectively for 1986 to 1988 combined and 1989 to 1991 combined. **The tables do not show any real evidence that any particular category of name was allocated to more or less risky syndicates or that there was any particular bias in the way that new capacity was allocated.**

**TABLE 5.19**

**Cumulative percentage of new capacity allocated to risk groups for each category of name**

<i>Risk group</i>	<i>Directors of agents</i>	<i>Directors of brokers</i>	<i>Other working</i>	<i>Relations</i>	<i>External</i>
<b>1986-1988</b>					
1	19.3	18.5	19.0	17.0	15.6
2	57.8	57.2	58.7	55.2	54.8
3	80.7	81.1	82.1	80.5	80.5
4	98.8	99.1	98.9	99.1	98.9
No risk category allocated	1.2	0.9	1.1	0.9	1.1
<b>1989-1991</b>					
1	21.6	21.9	22.7	22.6	22.1
2	58.5	58.7	58.9	59.8	60.1
3	78.2	79.5	79.6	80.5	81.2
4	100.0	100.0	100.0	100.0	100.0
No risk category allocated	0	0	0	0	0

TABLE 5.19a

**Cumulative percentage of capacity allocated to risk groups for each category of name**

<i>Risk group</i>	<i>Directors of agents</i>	<i>Directors of brokers</i>	<i>Other working</i>	<i>Relations</i>	<i>External</i>
<b>1986-1988</b>					
1	18.6	18.4	19.2	17.3	16.1
2	57.4	57.3	59.1	56.9	57.0
3	80.8	81.8	83.0	81.5	82.0
4	98.7	98.7	98.6	98.8	98.7
No risk category allocated	1.3	1.3	1.4	1.2	1.3
<b>1989-1991</b>					
1	20.0	19.7	20.4	19.5	18.5
2	57.2	56.7	58.3	58.0	58.4
3	80.2	80.6	81.9	82.6	83.2
4	100.0	100.0	100.0	100.0	100.0
No risk category allocated	0.0	0.0	0.0	0.0	0.0

#### **Analysis of LMX loss review syndicates**

5.20 For each of the years 1983 to 1991, an analysis has been made of the capacity and new capacity allocated to the 10 syndicates that wrote LMX business in 1989 and are currently the subject of a loss review. The syndicates are listed at the bottom of Table 5.13. Details of that analysis are given in Appendix C.4. In the same appendix we also give the same analysis but for the market as a whole. Table 5.20 below shows the percentage of new capacity that was allocated to external names in each year both on the 10 LMX Loss Review syndicates and for the whole of Lloyd's. **The table indicates that proportionately more of the new capacity was allocated to external names on the 10 LMX Loss Review syndicates than on Lloyd's syndicates overall.**

TABLE 5.20

**Comparison of allocation of new capacity to 10 LMX loss review syndicates compared with whole of Lloyd's**

<i>Underwriting year</i>	<i>Percentage of total new capacity allocated to external names</i>	
	<i>10 LMX loss review syndicates</i>	<i>Whole of Lloyd's</i>
1984	85.3	84.8
1985	89.3	84.5
1986	90.0	85.1
1987	87.1	82.9
1988	87.3	83.2
1989	89.7	84.1

**Miscellaneous analyses**

5.21 In addition to the analyses described above, three additional analyses were undertaken to investigate particular features of the market. These were as follows:

- (i) An investigation to assess whether external names were proportionately over or under represented in the 1,000 most profitable and least profitable names in recent years. This was intended to support the enquiry into preferencing.
- (ii) An analysis of the returns achieved by the directors of members' agents compared with the returns obtained by the names on their agencies. This was intended to see if the fortunes of the directors of a members' agent followed those of its names.
- (iii) An analysis to see whether the underwriters of good syndicates took a larger share of the capacity of their syndicates compared with the underwriters of bad syndicates.

**Top and bottom 1,000 names**

5.22 For each of the years 1983 to 1989, the most and least profitable 1,000 names were split into the five main categories of names. In the analysis profitability was defined as the return on a £10,000 line written by the name. The representation of the external names among the least profitable names is heavier in the first two years than in the other years. Thus the analysis has been summarised by averaging the representation over the period 1985 to 1989. The results are given in Table 5.22 below. **This shows that although there is a much higher proportion of external names in the bottom 1,000 than in the top 1,000, the proportion is not out of line with the market as a whole.**

**TABLE 5.22**

**Top and bottom 1,000 names for 1985 to 1989**

Category of name	Proportion as a percentage of:		Total market
	Top 1,000 names	Bottom 1,000 names	
Directors of agents	7.3	4.2	3.6
Directors of brokers	10.9	5.0	4.5
Other working	20.5	10.7	7.5
Relations	4.4	5.0	5.4
External	56.9	75.2	78.9

**Individual members' agents**

5.23 For each of the years 1987 to 1989, the average percentage return on capacity achieved by the directors of each members' agent were compared with the average percentage return obtained by the names whose affairs were handled by that agent. The comparison was made by taking the difference between the returns. The average difference for each year for all agents' combined is shown in Table 5.23 below. **From that table it can be seen that, in all three years, the average return of a members' agent exceeded the return of the names he represented, with the excess being particularly marked for 1989. The differences do not alter significantly if the returns are weighted by capacity.**

**TABLE 5.23**

<i>Underwriting year</i>	<i>Members' agents' return less external names' return (percentage points)</i>
1987	0.3
1988	1.2
1989	4.3

Appendix C.5 contains graphs showing the distribution of the differences for each of the three years. These indicate that there is quite a spread of differences over the members' agents, with the majority of the differences being clustered round the amounts given in the table above.

**Underwriters' capacity** 5.24 An analysis was made to see whether the underwriters of good or bad syndicates took proportionately more or less of the capacity available on their own syndicates. **The results are summarised in Table 5.24 below, which shows the percentage of the syndicates' capacity taken by the active underwriter on the top and bottom syndicates over three periods of years. Except for the 10 top and bottom syndicates this does not appear to show any clear trend, and even for the best and worst 10 it is weak.**

**TABLE 5.24****Underwriters' percentage share of syndicate capacity**

	<i>1983 - 1985</i>	<i>1986 - 1988</i>	<i>1989 - 1991</i>
Top 10	0.69	0.43	0.44
Top 20	0.38	0.30	0.30
Top 40	0.38	0.25	0.24
Bottom 40	0.33	0.23	0.37
Bottom 20	0.36	0.28	0.43
Bottom 10	0.24	0.25	0.20

**CONCLUSIONS** 5.25 The data maintained by Lloyd's on syndicate participations and performance is not in a form which readily facilitates analysis of the kind that has been undertaken in this review and some approximations have been necessary. Nevertheless the analyses of syndicate participation between 1983 and 1990 set out in this chapter lead the committee to the following conclusions:

- (i) Working names, and in particular directors of Lloyd's brokers, have a greater share of the capacity of more profitable syndicates than their share of the total Lloyd's capacity. The new capacity of working names has been allocated similarly, in part reflecting the relative ease of access of existing names on a syndicate to any new capacity sought by that syndicate. Consequently, working names have generally, though not always, obtained better returns than external names. (See paras 5.13, 5.14, 5.16 and 5.17)
- (ii) The capacity of working names allocated to LMX syndicates was broadly in line with their share of total Lloyd's capacity, except that working names were proportionately under-represented on the 10 LMX syndicates subject to loss reviews. (See paras 5.16, 5.17 and 5.20)
- (iii) Overall, the directors of members' agents have enjoyed better returns, particularly in 1989, than the external names represented by their agencies, although this was not the case for all members' agents. (See para 5.23)
- (iv) The capacity of external names was allocated over the 4 categories of riskiness into which the committee has analysed syndicates in a very similar manner to working names. (See para 5.19)

# 6

## Syndicate participations: critical appraisal

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6.1 Since syndicate participations at Lloyd's are not tradeable, it is unsurprising that methods of syndicate allocation attract keen attention and interest in circumstances in which divergences in performance of syndicates are as great as they have been in recent years. The committee note the intention of the Council to provide for the early introduction of members' agent pooling arrangements (MAPA); they also welcome the Task Force recommendation that the Council should be committed to consider the concept of value for syndicate participations at the end of 1994. But even if found practicable, the latter is a long way ahead: and while the availability of MAPA will automatically reduce the scope for conflicts of interest between members' agents and their names, it will not be mandatory, at any rate in the immediate future, and concerns about equity in capacity allocation are in any event not confined to names writing the average amounts, around £500,000, for which MAPA is envisaged. It follows, especially in the light of the experience described in Chapter 5, that there are proper concerns about the equity of capacity allocations that remain to be addressed.

6.2 The members' agent plays a pivotal role in this respect. The wider duties of the members' agent divide into fiduciary duties, that is, the obligation of the members' agent to act in what he honestly believes to be the interest of his principal, and his duties of skill care and diligence. Chapter 7 reviews the performance by members' agents in the latter respect: the present chapter reviews the performance of their fiduciary duties.

6.3 These duties of any agent are the duties of good faith, and have recently been summarised by the Law Commission \* as follows:

- (a) the no conflict rule: a fiduciary must not place himself in a position where his own interest conflicts with that of his customer, the beneficiary;
- (b) the no profit rule: a fiduciary must not profit from his position at the expense of his customer, the beneficiary;
- (c) the undivided loyalty rule: a fiduciary has undivided loyalty to his customer, the beneficiary, and therefore must not place himself in a position where his duty towards one customer conflicts with the duty he owes to another. A consequence of this duty is that a fiduciary must make available to a customer all the information that is relevant to a customer's affairs;
- (d) the confidentiality rule: a fiduciary must use information obtained in confidence from his customer the beneficiary for the benefit of the customer and must not use it for his own advantage or for the benefit of any other person.

6.4 The record revealed by the analysis described in the previous chapter is a mixed one. It suggests that there is exaggeration in some of the generalised criticisms and allegations that have been made in respect of "preferencing" and "dumping". But while the earlier advantaging of insiders that arose through baby syndicates had substantially

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\* Law Commission Consultative Paper No.124, Fiduciary Duties and Regulatory Rules, paragraph 2.4.9.



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disappeared by the mid-1980s, it is clear that working names have generally, though not always, obtained better returns than external names, that working names were proportionately under-represented on the 10 LMX syndicates subject to loss reviews and that, overall, the directors of members' agents had better returns than their names, particularly in 1989, though this is not the case for all members' agents. In interpretation of this record, the following factors are relevant:

- (a) there was enthusiasm on the part of some external names to join apparently profitable LMX syndicates in the mid-1980s. Published appraisals of syndicate performance could, in some cases, have lent support to this enthusiasm;
- (b) some managing agents and active underwriters did emphasize the high risk of the LMX business that they were writing but it appears that this was not effectively communicated to names by all members' agents;
- (c) given that other syndicates were in general not seeking new capacity in the mid and later 1980s, it is not surprising that LMX syndicates absorbed a substantial proportion of new names and capacity since LMX business was still expanding - this does, however, leave for consideration how well advised these names were by their members' agents, given also that directors of members' agents were under-represented on the LMX loss review syndicates;
- (d) members' agents were nonetheless themselves prominent participants and, in some cases, increased their lines on what were to become the biggest loss-making LMX syndicates;
- (e) some of the participations of working names on more successful syndicates were acquired when those syndicates were new and of quite uncertain performance and profitability; while there are no formal pre-emption rights, it seems clear that, where a sought-after syndicate expanded capacity, a degree of priority was given to existing names on the syndicate, reinforcing the position of insiders who may have been founder members;
- (f) although it is the responsibility of members' agents to ensure that their names are as well advised as possible, the inevitably better knowledge and understanding of the business and market on the part of working names - and no doubt a degree of inertia on the part of both members' agents and names themselves in respect of the existing participations of external names - means that a modest bias in favour of insider names should not be regarded as surprising or unacceptable; the policy concern for Lloyd's must be to ensure that any such bias is not immodest;
- (g) it is plain that there was a commercial interest for members' agents in boosting their income by recruiting new names and allocating capacity to them.

6.5 Two major issues in establishing criteria for equitable allocation of new capacity are, first, whether all names should have a right of "equal access" to syndicates; and, second, whether existing names should have pre-emption rights (or rights of first refusal) in respect of any expansion in syndicate capacity. But "equal access" would be

difficult, if not impossible to achieve in the absence of trading in syndicate participations. As to pre-emption rights, there is an element of inconsistency between syndicate participation as a 12-month venture and the rights effectively enjoyed by existing syndicate members, who tend to have preference when capacity is increased. An explicit enshrining of pre-emption rights, if it could be accomplished, would strengthen the position of existing syndicate members but would also make it still more difficult for new names to join sought-after syndicates when their capacity is being expanded.

6.6 The committee have also had regard to the fact that, ahead of a public offer for sale, it is a matter for the proprietors of any private business to determine from what sources capital needed for the business should be secured. The analogy with Lloyd's is of course very imperfect, but we do not regard it as inequitable that managing agents and active underwriters should be able to decide with which members' agents they deal in tapping new capacity for the syndicates that they manage. Specifically, the committee would not favour obliging managing agents to tap the market for new capacity on an open tender basis: underwriting business at Lloyd's should be under no greater obligation in this respect than any other private business.

6.7 On this basis, the committee believe that workable criteria for assessing and ensuring equity in the allocation of syndicate capacity to names must necessarily focus on the duties of members' agents. In the light of some of the experience of the 1980s, it is difficult to avoid the conclusion that some members' agents took a very lax view of their fiduciary duties. However, the extent of such laxity cannot be gauged precisely given the uncertainty about the extent of pressure on members' agents effectively to "frank" the syndicate participation of market insiders such as brokers who, it is argued, might be expected to bring attractive additional business or to refrain from presenting their less attractive business to syndicates on which they write.

6.8 For the future, the committee believe that there should be greater openness about syndicate participations and that explicit duties should be laid on members' agents to underpin and reinforce their existing fiduciary obligations under the law of agency. For this purpose, we take the relevant part of the fiduciary duty as being to treat all names equally and not to give preference, the obverse of equitable treatment, to any one name or group of names. We believe that such regulatory underpinning, coupled with the action to enhance members' agents' performance of their duties with skill, care and diligence, as set out in the following chapter, needs to be put in place as soon as possible to help to restore the confidence of names.

6.9 We have considered the particular argument that according preferential treatment to a broker is justifiable because of the additional business that he may bring to a syndicate on which he underwrites. In this context, we have particularly in mind the policy concern to boost the flow of attractive business from Lloyd's brokers to Lloyd's syndicates rather than to corporate reinsurers. But we do not find the argument persuasive on balance, partly because of the impracticability of monitoring a rule that enables a members' agent to give priority to a broker in expectation of a consequent business advantage to the syndicate; but partly also because of the relative strength of the syndicate participations enjoyed by Lloyd's brokers (see, for example, Table 5.13).

6.10 We thus conclude that there should be new rules to underpin the fiduciary obligations of members' agents which, with only one exception, should operate to prevent working members from making their own direct arrangements for the allocation of capacity and thus effectively circumventing their own members' agents.

6.11 The tables presented in chapter 5 reflect a substantial amount of data processing and analysis. Further analyses are plainly possible. The committee attach importance to making publicly available the comprehensive data base that has now been compiled so that any who wish to undertake further analysis of this kind are able to do so. For the future, we hope that Lloyd's will collect and publish comparable data on an annual basis so that, in the absence of trading in participations at Lloyds, there is comprehensive disclosure of syndicate participations and performance on the lines undertaken in this review. It is the firm view of the committee that confidentiality considerations should not stand in the way of this.

6.12 We accordingly recommend:

- (a) **the collection and publication by Lloyd's on an annual basis (in machine-readable as well as hard copy form) of data on syndicate performance and on changes in syndicate capacity by name group on the basis of the following minimum breakdown:-**
  - (i) **directors on group boards and managing agents (including active underwriters);**
  - (ii) **directors of members' agents;**
  - (iii) **directors of brokers;**
  - (iv) **other active working names;**
  - (v) **retired working names;**
  - (vi) **relations of names in categories (i)-(v) above;**
  - (vii) **non-working names**
- (b) **that syndicates should be required to incorporate in syndicate annual reports a breakdown of changes in syndicate participations as in (a) above, with changes in lines attributable to directors of the managing agent and active underwriters separately identified;**
- (c) **that members' agents in future should not accept offers of new capacity to them or to any of their names unless that capacity is to be allocated equitably among all of their names. A derogation should, however, be allowed where the**

**offer of capacity is to a name who is a director or employee of the managing agent \* of the syndicate offering the capacity.**

- (d) that members' agents' annual policy statements to names should indicate clearly and explicitly their policy on the allocation of capacity to names who are either new to the agency or existing names who wish to change their present allocation of capacity.**
- (e) that when directors of managing agents or active underwriters indicate to a members' agent their intention to reduce their underwriting or withdraw from the syndicate altogether in the following year, the members' agent should take this into account in deciding on the scale of future participations in the syndicate for other agency names and be able to indicate to the regulator that he had done so.**
- (f) as part of a more active regulatory role in relation to agents generally, Lloyd's should monitor compliance with the new obligations as set out above.**

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\* Active underwriters are already required by byelaw to be members of the syndicates for which they underwrite.

# 7

## The role and performance of members' agents

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7.1 The two previous chapters relate to the role of members' agents in managing syndicate participations of their names. This chapter addresses other aspects of the responsibilities, and performance of those responsibilities, of members' agents.

7.2 The duties owed by a members' agent to his names are, in addition to any specific obligations imposed by agreement between them, the ordinary duties of any agent for reward. These were summarised in the Neill Report\* as being that the agent:

- (a) will act in what he honestly believes to be the interest of his principal, the name;
- (b) will exercise reasonable skill, care and diligence in conducting business on behalf of the principal.

7.3 The performance of members' agents under (a) above is reviewed in the previous chapter. This chapter is concerned with the agent's duty of skill, care and diligence. A paid agent must exercise such skill, care and diligence in the performance of his undertaking as is usual or necessary in or for the ordinary or proper conduct of the professional business in which he is employed or is reasonably necessary for the proper performance of the duties undertaken by him. Where the agent's role involves advice, or the exercise of discretion, this duty will require the agent to "know his customer" and to follow a suitability principle in advising him or exercising discretion for him.

7.4 These duties under the law of agency have, over the past decade, been supplemented for Lloyd's members' agents by provisions under successive byelaws and codes of practice, requiring the members' agent:

- (a) to advise the name on which syndicates to join and to agree with the name the allocation of premium income among syndicates from year to year;
- (b) to maintain regular contact with the name so that any change in the name's circumstances can be assessed;
- (c) to keep under review the performance of each syndicate on which the name participates;
- (d) to satisfy himself that the name could realise sufficient resources in the event of a sizeable loss;
- (e) to make full disclosure of any interests that it may have that may give rise to a conflict of interests and to send to all names a copy of an annual disclosure of interests statement;
- (f) to advise the name generally on his Lloyd's affairs.

7.5 Although these requirements are described as supplementary to duties under the law of agency, they are in practice little more than an articulation of those duties with

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\* Neill Report, paragraph 6.24, quoting the Fisher Report, paragraph 9.18

specific reference to the Lloyd's context. The performance of members' agents by these criteria appears to have improved significantly in recent years and what appear to be present standards of best practice are high. This improvement reflects the fuller disclosure obligations that have now been imposed, a process of concentration in which weaker agencies have either been absorbed or left the market altogether (there were 271 members' agents in 1981 and the number had fallen to 111 a decade later) and the increasing expectations and insistence of many names on better standards of service and advice. But it is clear that standards of performance of some members' agencies in the mid and later 1980s fell far short of what has now become best practice. The committee do not believe that adequate minimum standards of performance are being achieved uniformly even now and considers that more monitorable standards of disclosure and business conduct should be designed and introduced.

7.6 The committee's approach and the time available has not allowed an examination of the performance of all or even a representative sample of members' agencies, but the committee has seen sufficient evidence on the performance of members' agencies that placed names on the principal loss-making syndicates, and find this very disconcerting. While some of the names' criticisms and allegations, as summarised in Appendix B, may be incapable of substantiation and may, in some cases, be exaggerated, it is difficult to avoid the conclusion that these criticisms, taken together, reflect serious deficiencies in the performance of a small number of members' agents. These included a cavalier approach to names and, in some instances, apparent disregard of their specific preferences or instructions; failure to appreciate and to inform names of the risks in writing particular kinds of business; and a related failure to assess adequately the suitability of such business given the circumstances of individual names. The committee find it difficult to believe that their interests in recruiting new names - using introducing intermediaries in some cases - and in placing additional capacity on syndicates enabled such agents easily to keep their duty to names ahead of their interest in the profitability of their agencies.

7.7 Given the complexity of their Lloyd's affairs, it is inevitable that names should wish to be able to place heavy reliance on their agents and they pay substantial sums in agency fees in expectation that their agents' advice will protect and add value to their interests. But the basis for such reliance has latterly been seriously eroded for many names. Moreover, the financial resources typically available to members' agents, and the much reduced availability of errors and omissions cover, mean that even a successful litigation may not be capable of compensating a name for damage sustained as a result of negligence or any other failure of duty on the part of the agent.

7.8 Also relevant here is that, while the Neill report recommended reasonable parity between the regulatory protections available to a name and those available to investors under the Financial Services Act, Lloyd's regulatory approach has been, and remains, much more reactive than that of the FSA regulators. The reasons for this difference included the Lloyd's belief, not sufficiently validated in the event, that higher standards of disclosure by agents to their names would suffice to ensure adequately high minimum standards and a continuing tradition that the Lloyd's regulators should stand back from

market matters unless there is evidence of misconduct. In consequence, Lloyd's regulatory activity - apart from the development of new policy - has tended to relate to investigations and pursuit of disciplinary matters rather than, as a form of preventive medicine, pro-active monitoring of compliance with specific conduct of business requirements.

7.9 In the committee's view, this stance is no longer adequate in relation to regulatory oversight of the crucial role of members' agents. Indeed, given the limited financial resources available to the typical members' agent, regulation should to a much greater extent be a surrogate for the protection available to a name through recourse to remedies available through the courts. Leaving aside the matter of disclosure in relation to any preferencing in syndicate allocations, as addressed in chapter 6, the committees's attention and recommendations focus on three areas.

7.10 The first relates to the agent's duty to know his principal. Although part of the problem in relation to LMX syndicates has been associated with the failure of agents (managing as well as members') to appreciate the nature of the aggregate risks being incurred, the committee are not persuaded that members' agents were or, even now, are sufficiently attentive to the circumstances and wishes of their names. In this situation, there is need for agents to undertake a regular annual reappraisal of the financial position and preferences of their names on the basis of a written exchange with each name.

7.11 In this context, it is of particular importance that the members' agent should know what part, if any, of a name's share of assets in support of underwriting at Lloyd's is in the form of a bank guarantee on the principal residence. The committee accordingly conclude that members' agents should be required to send to each of their names on an annual basis a summary of what they understand to be the factors relevant to be the name's underwriting for the year ahead, with a request that the name confirms that this is a correct statement or indicates any necessary modification<sup>†</sup>. It is important that this annual verification process should be recorded and that compliance with it be capable of monitoring by the regulator.

7.12 The second area for attention relates to the assessment of risk, addressed more fully in chapter 8 in relation to managing agents. It seems that some members' agents were inadequately informed about or did not understand the potential risks involved in LMX business or were not equipped to carry out effectively their own syndicate analysis and monitoring, and so were not in a position to assess the suitability of participations in LMX syndicates for their names. The committee believe that a statement of syndicate underwriting policy, with an indication of policy in relation to the protection of exposures, can and should be made available by managing agents to members' agents. This would be in the form of an indication of the planned balance of underwriting in individual syndicates over the year ahead, and the members' agent would then be able to take this into account in advising his names and in disclosing to names the particular

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<sup>†</sup> It should be noted that names themselves are already under an obligation to inform their members' agents promptly of any change in their personal circumstances that is material for their underwriting.

spread of risks to which they would be exposed. The availability of such information to the members' agent and the way in which the agent relates this to the circumstances of the individual name would be monitorable by the regulator.

7.13 The third relates to the assessment of fitness and propriety and continuing performance of members' agents. The committee consider that standards for the registration of members' agents have been insufficiently rigorous in the past, with some flavour that more emphasis may have been given to helping applicants over the stile than to the filtering out of the unsuitable. Standards of best practice must now be more consistently achieved and could be promoted in part by granting registration on a limited-term basis, say for 3 years only, as a means of keeping agents more sharply on their toes; and by more pro-active regulatory monitoring of compliance, in particular with business conduct obligations as recommended above in respect of "know your principal" and risk. The committee attach importance more generally to a more active regulatory stance.

**7.14 The committee accordingly recommend that:**

- (a) a new regulatory provision should be introduced to require members' agents to undertake an annual reappraisal, in writing, of the circumstances and preferences of their names;**
- (b) a new regulatory provision be introduced to require members' agents to advise names on the risks of particular syndicate participations by reference to syndicate policy statements, with risk categorisations and an indication of policy on the protection of exposures;**
- (c) consistently with the importance that we attach more generally to a more active regulatory stance, both the requirements for initial registration and the intensity of regulatory monitoring of agency performance should be strengthened and firmly applied, with the possibility of limited-term registration reviewed as an additional measure in the light of progress made over the next 12 months.**



# 8

## The role and performance of managing agents

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8.1 In relation to the engagement of a syndicate in underwriting, the relevant duties of the managing agent comprise:

- (a) the appointment of the active underwriter;
- (b) the conduct of the underwriting and acceptance of risks on behalf of members of the syndicate;
- (c) the effecting of the reinsurance programme;
- (d) the establishment of systems to monitor and control the premium income written by the syndicate;
- (e) keeping members' agents and names properly informed of material developments in, and the activities of, the syndicate.

Although these and other responsibilities of members' agents were specifically set out in the standard agreements in the Agency Agreements Byelaw of 1988, managing agents had effectively the same responsibilities throughout the whole period of the LMX spiral in the 1980s with which the committee is concerned.

8.2 Great emphasis is placed by Lloyd's on the need for the active underwriter to retain substantial flexibility and freedom of manoeuvre. It is argued that this enables him to respond quickly to changing market conditions and to seize opportunities that the corporate reinsurer may be slower to identify and slower still to be able to take up; and that this traditional differentiation between Lloyd's and corporate underwriters has been an important element in the long-term success of Lloyd's, particularly in specialist areas of business.

8.3 The committee share this view and would not wish to see these distinctive characteristics disturbed or displaced in a way that would unreasonably constrain the ability of Lloyd's underwriters to innovate and react quickly to changing market conditions. But while this latitude has been and should continue to be a source of competitive strength for Lloyd's, recent experience of the LMX spiral demonstrates that inadequate control of an active underwriter can become a major source of weakness, not only for individual syndicates but for the whole market. In reviewing this control issue, the committee have had particularly in mind three factors that have had substantial significance in the context of the LMX spiral. These are discussed more fully in chapters 3 and 4 but merit repetition here.

8.4 First, because of the assurances that valid Lloyd's policies will always be paid, cedants, whether other Lloyd's syndicates or corporates, are under no sense of obligation to undertake a credit risk assessment of a Lloyd's syndicate providing reinsurance cover for their exposures. The availability of this assurance is a great competitive strength for Lloyd's, in particular against the background of the fragility and failure of some corporate reinsurers in the 1980s. But it also means that a major market

discipline present in other financial service business is not present in Lloyd's, and thus an underwriter can gear up with what may be under-priced and relatively unattractive business without the brake of any form of credit constraint by his client base. This problem is compounded by the solvency provisions that predispose Lloyd's syndicates to seek to meet their reinsurance protection requirements within the Lloyd's market by limiting the credit that can be taken for reinsurances obtained outside Lloyd's.

8.5 Second, premium income monitoring has not been and is not a satisfactory means of regulatory monitoring still less a constraint on the ratio of unprotected exposures to syndicate capacity. This regulation has not acted as surrogate or compensated for the weakness or absence of market discipline in this respect, and in some degree gave a false sense of security to names. Hence the committee's recommendations in chapter 4 that work should be initiated to yield a set of risk weights for different types of business, to set limits to the proportion of a name's underwriting in higher risk categories and as an indicative guide for the regulator for purposes of premium income monitoring. But progress on these lines will still not remove the need for the achievement and maintenance of consistently high standards of performance by managing agents.

8.6 Third, the commercial motives for marine underwriters to write LMX business appear in some cases to have been stronger than their capabilities to make the transition; and regulatory control of the fitness and propriety of active underwriters via the Underwriting Agents Registration Committee (UARC) was not designed and did not operate to licence underwriters for particular classes of business.

8.7 In these circumstances, the quality of controls exercised by the managing agent within the framework of responsibilities set out in para 8.1 was and is crucial. The committee believe that standards of best practice being followed by the better managing agents are high and, in summary terms, include:

- (a) the maintenance of up-to-date syndicate records on aggregate exposures with appropriate geographical and other breakdown for different classes of business as a basis for appraisal of probable maximum loss;
- (b) the preparation of detailed underwriting policy plans by active underwriters, indicating the level of premium proposed both gross and net of the cost of outward reinsurance;
- (c) peer group appraisal at managing agent level of proposed underwriting policies;
- (d) frequent and regular monitoring at managing agent level of performance in relation to the plan and prior review and authorisation of proposed departures from the plan;
- (e) the provision to names of clear and informative reports about the underwriting business carried out by their syndicates.

8.8 But while such standards of practice and performance are now being achieved by many managing agents, they were not achieved by the managing agents of the worst-hit LMX syndicates. Loss Review Committees are examining the circumstances of each such syndicate individually. But in general, the managing agents of these syndicates do not appear to have been able to exercise appropriate control over their active underwriters. This may have reflected the substantial influence of the individual underwriters concerned over the boards themselves and the absence of an effective provision for peer group review of either underwriting policies and decisions. The ethos that "the underwriter is king" appears to have been accepted in some cases to an unqualified extent, so that in cases where - as has been suggested to the committee - active underwriters were neither adequately reporting nor, perhaps, recording their aggregate exposures, the managing agent's board either did not seek or was in no position to insist on the provision of timely control data or to question their active underwriters' policy judgement.

8.9 These deficiencies were increasingly highlighted in relation to specific managing agents in reviews undertaken by the General Review Department (GRD) from 1989 onwards. In respect of four badly-hit LMX syndicates, findings of the GRD reviews, initiated in the first case in mid-1989, prominently included concerns:

- (a) as to the adequacy of resources and effectiveness of managing agents in discharging their responsibilities of supervision of managed syndicates;
- (b) at the perception by managing agents' boards of their role as merely a central support function, with only a marginal role in controlling syndicates; with an unwillingness on the part of active underwriter directors to involve themselves in monitoring sister syndicates; and, given that what they regarded as their own specialised business, a questioning on the part of active underwriters of the competence of the board to review their syndicates;
- (c) as to the fitness and properness of an agent's board to manage the affairs of the managed syndicates, with attention drawn to inadequate leadership at board level and the absence of necessary information, control and strategy.

8.10 These GRD assessments, which appear to the committee to have been rigorous and thorough, were undertaken at a relatively late stage in the history of the LMX spiral. The committee understand that, to the extent that corrective action could be taken in the light of these reports (as against the conversion of individual syndicates into run-off) it has been taken. Given the nature of these reports, and their disturbing findings, it is with hindsight unfortunate that such GRD reviews were not launched two or three years earlier, though the committee are aware that GRD was then in its infancy. In the view of the committee, it is of great importance that the priority and weight attached to such reviews should be increased: that their frequency, based on both periodic inspection visits and also undertaken ad hoc on a more selective basis, should be increased; and that the capability of Lloyd's as regulator should be enhanced for this purpose.

8.11 The managing agent has key responsibilities in the complex architecture of checks and balances that govern insurance business transacted at Lloyd's. In the committee's view, there should accordingly be no compromise or dilution in respect of Lloyd's regulatory insistence on the achievement of satisfactory minimum standards by managing agents. It follows that, where corrective action is recommended or sought by Lloyd's on the basis of regulatory review of the competence and performance of a managing agent, the expectation should be that the necessary changes will be implemented without delay.

8.12 Such action will depend partly on respect for the capability and authority of the regulator in such areas where, until comparatively recently, Lloyd's has not sought to exercise a pro-active regulatory role and for it to have done so would have been counter-cultural. The culture in this respect will need to change. We believe that this will be facilitated if a more pro-active regulatory stance is underpinned by provision for appropriate practitioner input. Ideally, it would be desirable for the Lloyd's regulatory team to include staff with practitioner experience, but the committee recognise the severe practical limits here. We believe that appropriate practitioner input might best be secured in respect of periodic inspection visits to managing (and members') agents through providing for regulatory access to an advisory panel of market practitioners, possibly including some who have recently retired from full-time involvement in the market. We believe that the ability of the regulators to call upon such market experience, on a wholly confidential basis, would reinforce the quality of regulatory assessments and recommendations. It should also enhance the authority and acceptability of findings made and of corrective action sought in relation to specific agents.

8.13 The committee considers that a development of regulatory policy on these lines is the best means of ensuring more consistently high standards of performance by managing agents and that this should accordingly be pursued with vigour. It has been suggested that a complementary approach to raising agents' standards would be to provide for agency registration on limited-term basis, say 3 years only, and that such a procedure could be a particularly effective means of ensuring that corrective action sought by the regulator is implemented swiftly. The committee hopes that a development in regulatory policy on the lines described in paras. 8.11 and 8.12 above would suffice, but the possibility of a switch to a limited-term registration of agents should be kept under review in the light of progress made.

8.14 Despite the weight that they attach to proper discharge of their responsibilities by managing agents, and more active monitoring in this respect by Lloyd's, the committee wish to emphasise the major distinction between the task of ensuring that satisfactory controls and systems are in place in managing agents, with a major oversight responsibility for Lloyd's as regulator, and underwriting judgements themselves, which should remain the responsibility of active underwriters within the framework established by the managing agent's board. Even the best-functioning managing agent's board cannot, of course, ensure that underwriting is profitable. But it should be able to provide for thorough peer group review of underwriting plans, to monitor compliance with them, to provide for prior appraisal of proposed departures from plan and to apply

timely restraint as necessary if there is any material unauthorised departure from such plans. This should minimise if not eliminate the risk of exceeding the aggregate exposures regarded as acceptable for the syndicate and disclosed to members' agents.

8.15 Active underwriters are understandably sensitive to what they see as encroachment on their autonomy and flexibility. Whatever it may have been at times in the past, that autonomy and flexibility cannot be unqualified now and in the period ahead. But the committee believe that a competent active underwriter should have little cause for apprehension about a framework in which the managing agent's board discharges its proper functions effectively, and that this should indeed maximise the freedom of manoeuvre of such an underwriter within the approved underwriting plan.

**8.16 Specifically, the committee recommend that:**

- (a) managing agents should be required to ensure that underwriting policy statements are prepared and authorised by reference to risk categories of business, as now being developed centrally by Lloyd's, and with indications of underwriting policy in relation to exposure of their syndicates. The format for this requirement should be established in consultation with market associations, but there should be sufficient commonality to ensure reasonable comparability among syndicates;**
- (b) such underwriting policy statements should be the basis for disclosure to members' agents of the risk categories of business to be written and of syndicate policy in relation to aggregate exposures and protection;**
- (c) managing agents should provide for peer review of underwriting policy statements and of syndicate performance within the framework of approved policy: where this is necessary to ensure such peer group review, an outside underwriter should be appointed to a managing agent's board;**
- (d) Lloyd's should develop a deliberately more active regulatory stance in respect of the monitoring of compliance with required standards for managing agents; the frequency of inspection visits should be increased and an advisory panel established to provide access to practitioner expertise in support of agency regulation.**

## Appendix A List of recommendations

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Specific recommendations made by the committee are as follows:—

### **Chapter 4 — The LMX spiral and regulatory policy**

4.7.a Lloyd's should undertake or commission a volatility analysis and risk assessment aimed at the development of a set of risk weights for different categories of business. This will require the central collection of additional data, including in particular data on estimated outstanding as well as paid claims; and the analysis should be regularly updated to ensure that the indicative weights that are derived are adapted as necessary to the changing characteristics of business over time.

4.7.b On the basis of risk weights yielded by such an analysis, upper limits should be set for the proportion of the total capacity of individual names that might be written in specified high risk categories. Apart from the derivation of risk weights, further work will be needed to determine which categories of underwriting should be constrained in this way, but the committee do not envisage more than a comparatively small number.

4.7.c The risk weights should be used indicatively in regulatory oversight of premium income monitoring, with closer attention to the monitoring of syndicates writing a substantial higher risk business and a stronger resistance by the regulator and, as necessary, timely sanction in the event of overwriting by such syndicates. Close regulatory attention of this kind should be directed at syndicates which are regarded in the market as writing business on a "soft" basis, and the regulators should look to ensure that they have access to good market intelligence in this respect.

4.7.d Lloyd's should liaise regularly with the market associations to evaluate the development of premium rates in particular categories of reinsurance business and be ready (as with quota share reinsurance in 1991) to adjust overall premium income limits inversely with premium rates where such adjustment would seem likely to provide for a better control of the ratio of total exposures to syndicate capacity.

4.7.e As a means of applying a regulatory constraint to the development of any future spiraling of reinsurance business within Lloyd's, permitted reinsurance limits allowed in the valuation of liabilities for the annual solvency test should include a limit on the permitted amount of reinsurance effected at Lloyd's, in adaptation of the present regime in which the allowance is unlimited. The committee believe that the most significant and desirable change is that some such limit should be introduced: it does not need to be severe.

### **Chapter 6 — Syndicate participations: critical appraisal**

6.12.a The collection and publication by Lloyd's on an annual basis (in machine-readable as well as hard copy form) of data on syndicate performance and on changes on syndicate capacity by name group on the basis of the following minimum breakdown:—

- (i) directors on group boards and managing agents (including active underwriters);
- (ii) directors of members' agents;

- (iii) directors of brokers;
- (iv) other active working names;
- (v) retired working names;
- (vi) relations of names in categories (i)-(v) above;
- (vii) non-working names.

6.12.b That syndicates should be required to incorporate in syndicate annual reports a breakdown of changes in syndicate participations as in (a) above, with changes in lines attributable to directors of the managing agent and active underwriters separately identified.

6.12.c That members' agents in future should not accept offers of new capacity to them or to any of their names unless that capacity is to be allocated equitably among all of their names. A derogation should, however, be allowed where the offer of capacity is to a name who is a director or employee of the managing agent\* of the syndicate offering the capacity.

6.12.d That members' agents' annual policy statements to names should indicate clearly and explicitly their policy on the allocation of capacity to names who are either new to the agency or existing names who wish to change their present allocation of capacity.

6.12.e That when directors of managing agents or active underwriters indicate to a members' agent their intention to reduce their underwriting or withdraw from the syndicate altogether in the following year, the members' agent should take this into account in deciding on the scale of future participations in the syndicate for other agency names and be able to indicate to the regulator that he had done so.

6.12.f As part of a more active regulatory role in relation to agents generally, Lloyd's should monitor compliance with the new obligations as set out above.

## **Chapter 7 — The role and performance of members' agents**

7.14.a A new regulatory provision should be introduced to require members' agents to undertake an annual reappraisal, in writing, of the circumstances and preferences of their names.

7.14.b A new regulatory provision be introduced to require members' agents to advise names on the risks of particular syndicate participations by reference to syndicate policy statements, with risk categorisations and an indication of policy on the protection of exposures.

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\*Active underwriters are already required by byelaw to be members of the syndicates for which they underwrite.

7.14.c Consistently with the importance that we attach more generally to a more active regulatory stance, both the requirements for initial registration and the intensity of regulatory monitoring of agency performance should be strengthened and firmly applied, with the possibility of limited-term registration reviewed as an additional measure in the light of progress made over the next 12 months.

**Chapter 8 — The role  
and performance of  
managing agents**

8.16.a Managing agents should be required to ensure that underwriting policy statements are prepared and authorised by reference to risk categories of business, as now being developed centrally by Lloyd's, and with indications of underwriting policy in relation to exposure of their syndicates. The format for this requirement should be established in consultation with market associations, but there should be sufficient commonality to ensure reasonable comparability among syndicates.

8.16.b Such underwriting policy statements should be the basis for disclosure to members' agents of the risk categories of business to be written and of syndicate policy in relation to aggregate exposures and protection.

8.16.c Managing agents should provide for peer review of underwriting policy statements and of syndicate performance within the framework of approved policy: where this is necessary to ensure such peer group review, an outside underwriter should be appointed to a managing agent's board.

8.16.d Lloyd's should develop a deliberately more active regulatory stance in respect of the monitoring of compliance with required standards for managing agents; the frequency of inspection visits should be increased and an advisory panel established to provide access to practitioner expertise in support of agency regulation.



## Appendix B      Summary of written submissions

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1. From the announcement of the establishment of the inquiry at the end of February 1992, in excess of 200 written submissions and letters have been received. They covered a broad range of topics and, while the majority of them were directed at the two major areas of work covered by the committee, some raised matters beyond the scope of the committee. The larger part of the submissions came from external names who had suffered notable losses. The committee decided to set out a summary of substantive matters raised in the submissions made, and this appendix accordingly reflects views put forward in submissions: the committee do not in this appendix express any opinion about the merits of these views.
2. In a number of instances those writing expressed general concern at the recent losses; made allegations of shortcomings in specific instances, often relating to the manner in which their affairs had been handled; put forward opinions about the matters under review, in some cases offering analyses or proposals for further analysis in relation to the allocation of capacity; and offered recommendations.
3. Much of the material under review relates to the work of members' agents. About half of the correspondence referred specifically to members' agents, much of it critical of their performance. The first part of this appendix deals with the correspondence about members' agents; other correspondence is summarised in the second part.

### MEMBERS' AGENTS

4. The general tenor of submissions was bitterness at what was regarded by names as misplaced trust in their members' agents. Most commonly names complained of the syndicates to which they were allocated, commenting that they were put on syndicates which appear to have been unsuitable for new names or names on lower means. Many names suggested that their agent should have advised them against participation in syndicates writing an account with any substantial quantity of LMX or other high risk business in it, at least where the name had not built up a significant personal reserve. Some names with lower incomes or bank guarantees secured on their principal residence felt that they should have been warned that such high risk business was unsuitable for them.
5. Others complained that they had not been warned by their agent of the high risk nature of LMX business. Some names stated that they had been placed on LMX syndicates despite requests to be put on safe and low risk syndicates. Submissions received from some names' action groups served to emphasise the observation made in correspondence from some individuals: a notable number of action group members and correspondents were not aware of the nature of LMX business or the type of risk it involved.
6. Some names remarked that they had not had any effective explanation of the reasons underlying the choice of the syndicates which made up their portfolios. This observation was in some cases set in the context of comments on members' agents' policy held out to names as a conservative approach which would neither make names a fortune nor lose them one.

7. In a number of submissions, names expressed the view that they had been ill-advised by their members' agent about personal stop-loss policies (PSL). Most of these names were aggrieved that they had been advised against taking out such policies. In a substantial proportion of these complaints, names asserted either that they had not been properly informed of the manner in which these policies operated, or that errors material to the cover available under them had been made when they were arranged. In one submission, an external name indicated that it was the premium quoted for his PSL which alerted him to the high risk nature of his syndicate allocations.

8. Many external names found it difficult to understand the magnitude of losses on certain LMX syndicates, and they questioned how losses of such size could have arisen without impropriety. A number of specific criticisms and allegations were levelled: the background of certain agency directors made them unsuitable to exercise their particular responsibilities; agents were deliberately 'fattened' with the recruitment of unsuitable names to increase the agent's income, and hence value, with a view to sale; combined agents arranged capacity on each others' LMX syndicates to generate artificial support and growth; directors of certain agents had underwriting results which significantly outperformed their names; and certain underwriters were only making capacity available to personal contacts.

9. It was apparent that, as might be expected, names had placed reliance on their members' agents, and perhaps understandably expected that their performance would not be significantly different from that of names with other members' agents. A small number of submissions from names who had changed agents in recent years commented on significant improvements in the service provided to them as a result of these changes. The two most notable improvements described were the degree of personal contact with their agent (one UK name commented that he had not seen his previous agent for over 2 years) and, second, the use of computer analysis to consider the name's exposure to particular categories of business across his entire portfolio, so preventing a build-up of exposure to any one category of business.

10. The case for divorce of managing and members' agency functions within combined agents was widely canvassed in submissions, some names believing that Chinese walls were not able to overcome potential conflicts of interest. Other recommendations centred on disclosure of interests by agents, agency charges and remuneration, and the allocation of capacity. These included: names should be notified mid-year if directors of their agent were ceasing to participate in syndicates so that they too could resign; agents' commissions should be based solely on performance, or only on utilised rather than allocated capacity; there should be a centralised procedure for the allocation of syndicate capacity to members' agents to ensure fair play; the underwriter should not be permitted to offer capacity on a personal basis; and names demonstrating lower means should, for their own benefit, be restricted from participating on high risk syndicates.

**OTHER ISSUES:  
SYNDICATE  
ALLOCATIONS  
AND LMX**

11. A number of submissions expressed views on allocation of capacity without directing their remarks at the conduct of members' agents. Some suggested broad aspects to consider when analysing this area, others proposed specific cases for investigation, yet others provided analysis and data in individual cases where agency directors were said to be outperforming their names. A common theme in correspondence alleging preferencing was the definition of 'insider'. Suggestions were made that retired working names should not be considered as insiders; all Council members should be regarded as insiders; agents' junior staff should not be included; major shareholders of agencies and brokers should be; and that relations of insiders (however defined) should also be regarded as insiders. Two other significant suggestions were to measure results against premium income rather than capacity; and to use risk factors to measure returns.

12. A range of possible analyses were suggested. Not all were relevant to the issue of whether the substantial losses recorded by some LMX syndicates for the 1988 and 1989 accounts led to external members suffering disproportionately to working members, but submissions included suggestions to review the performance of syndicates which have overwritten; to compare the results of combined and independent members' agents; to consider agents with representation on the Council of Lloyd's; to compare results to the length of names' membership of Lloyd's; to compare the results for names of different nationalities; and to include working names' salaries, bonuses, commissions, and dividends.

13. Some correspondence offered explanations to account for any differences between working and external names' results. Key proposals were that: the system of profit commission without appropriate deficit clauses might encourage agents to put names on high risk syndicates; working names tended to be less wealthy, and more aware of the level of riskiness of LMX syndicates and hence may have deliberately avoided this class of business; insiders may not know which are the better syndicates, but might know which ones to avoid; and combined agents have the power to get 'good' or 'safe' capacity for their names, whereas smaller independent agencies do not have the same leverage.

14. Submissions from external names on the LMX spiral were not in general of a technical nature. The view was of the spiral as an artificial device with the sole purpose of benefitting those within the market - especially brokers. It was submitted that the spiral should be unwound, or traced so as to discover and show who benefitted from it.

15. Submissions from market practitioners were also critical of the spiral but tended to focus on how it arose and on its operation. It was suggested that the availability of new capital in the market of the 1980s tended to promote the significant acceptance of LMX business in the newer syndicates. Another observation was that newer LMX syndicates appeared as a safer alternative to longer-established syndicates with potential exposure to asbestosis (and other latent disease) and pollution claims.

16. Many submissions from external names made suggestions for remedial action, a significant number seeking retrospective capping of losses. A number of correspondents suggested that the system of premium income monitoring was inadequate. Differential premium income limits determined by class of business were proposed, as were flexible premium limits to compensate for the hardening and softening of premium rates as described in the report of the Task Force.

**OTHER ISSUES** 17. Correspondence was received which raised other matters which were beyond the scope of the committee's work. Whilst this correspondence has received attention, the subject matter of it is accordingly not described in this appendix.

## Appendix C     Additional tables on syndicate participation

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### APPENDIX C.1

#### Top and bottom syndicates

##### 40 Top syndicates

42	271	557	839
44	372	575	861
45/177	382	590	925
48	386	624	942
97	398	648	952
172	399	657	955
179	429	687	959
218	447	741	960
260	536	800	998
270	545	820	1047

##### 40 Bottom syndicates

80	334	691	1097
105	342	764	1109
134	366	787	1114
162	383	843	1117
184	387	847	1118
185	421	901	1129
255	471	905	1137
290	540	1053	1139
298	553	1084	1143
325	604	1091	1148

## APPENDIX C.2

### Syndicate riskiness

For each Lloyd's audit code a risk coefficient has been determined. This was based on the consolidated data from the Lloyd's solvency department. For each audit code the ultimate loss ratio (ULR) and the standard deviation of the ULRs was calculated based on an actuarial analysis of the data. These deviations were ranked and assigned an indicator (Q) in the range 0-10. The time taken to reach 95 per cent. of the ULR was also estimated. These were ranked and assigned an indicator (W) in the range 0-5. The risk indicator for a given audit code is  $(Q+W)/2$ . The larger the number the greater the perceived risk. The risk indicators were then rescaled so that the least risky audit category (Aviation short tail) should have an indicator of 1.0. This lead to the most risky audit code (Non-marine all other) having an indicator of 28.74. A list of the risk indicators calculated for all the audit codes is given in Table C2.1 below.

TABLE C2.1

Audit category	Risk indicator
Aviation all other	8.76
Aviation short tail	1.00
Financial guarantee	9.50
Livestock	1.49
Marine liability	9.10
Motor overseas	2.96
Motor UK & ROI	1.81
Non-marine all other	28.74
Non-marine short tail	3.56
Time	7.28
TLO	2.28
UK Employers liability	4.38
Voyage	1.41
War	6.38
Yacht	3.70

For nearly all syndicates details were provided of the the mix of business written in the years 1987 and 1988. However it was often not available for earlier years. Unfortunately the splits of business were not by Lloyd's audit code but by the categories which an outside body, Financial Intelligence & Research Ltd ("FIR"), divide the business. The FIR categories have been allocated a unique Lloyd's audit code. This has allowed each category code to be allocated a risk coefficient. The risk coefficient for a syndicate has then been calculated as the average over the two years 1987 and 1988 of the weighted average (by capacity) of the coefficients allocated to the FIR codes. The syndicates were then allocated to 4 riskiness groups as shown in Table C2.2 below. For some syndicates have been allocated to group 0. For those syndicates for which it was possible to allocate a risk indicator, the lowest amount calculated for any syndicate was 1.48. All the results were therefore divided by this amount to produce final syndicate coefficients running from 1.0 to 19.39 as shown in the table.

**TABLE C2.2**

<b>Relative risk coefficient</b>	<b>Group</b>
0	0
1.00 to 3.90	1
4.01 to 7.94	2
8.00 to 11.92	3
12.20 to 19.39	4

### APPENDIX C.3

#### LMX Syndicates

28	256	428	635	847	1096
42	257	475	648	851	1097
102	263	478	660	872	1114
104	268	503	666	939	1121
164	272	509	674	957	1129
179	282	512	694	958	1139
183	290	529	702	1002	1143
185	298	536	733/607	1003	
197	299	540	735	1005	
205	318	546	740	1007	
216	321	552	744/746	1025	
219	363	561	745/748	1049	
227	376	566	787	1081	
228	384	573	808	1084	
235	401	575	824	1087	
255	421	577	833	1093	



## APPENDIX C.4

### Analysis of LMX loss review syndicates

#### Allocation of capacity and new capacity to loss review syndicates compared with the whole market

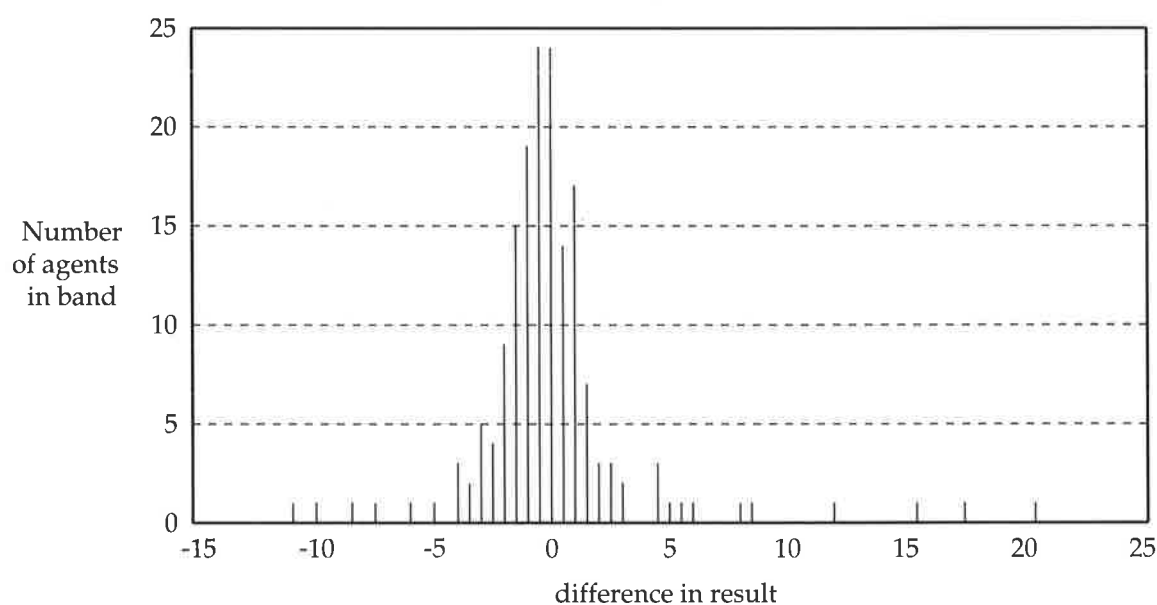
Underwriting year	Category of name	New capacity				Capacity			
		Spread Loss Review	Whole Market	Amount Loss Review	Whole Market	Spread Loss Review	Whole Market	Amount Loss Review	Whole Market
1983	Director of agent								
1983	Director of broker								
1983	Other working								
1983	Relations								
1983	External								
1984	Director of agent	3.2	3.4	0.9	30.2	3.8	4.1	2.9	155.8
1984	Director of broker	0.9	2.5	0.2	22.3	1.8	3.1	1.4	118.4
1984	Other working	2.4	3.7	0.6	33.6	2.3	3.7	1.8	142.3
1984	Relations	8.2	5.7	2.2	51.2	6.8	5.4	5.2	206.1
1984	External	85.3	84.7	22.6	763.0	85.3	83.8	64.9	3220.8
1985	Director of agent	1.9	3.4	0.9	50.0	3.1	4.0	3.7	196.6
1985	Director of broker	1.7	2.9	0.8	42.1	1.7	3.0	2.0	146.2
1985	Other working	1.3	3.3	0.6	48.8	2.0	3.5	2.4	174.9
1985	Relations	5.8	5.9	2.8	85.8	6.3	5.5	7.5	274.7
1985	External	89.3	84.5	42.5	1231.3	86.9	84.0	103.1	4161.3
1986	Director of agent	2.5	3.3	1.8	64.4	3.0	3.8	5.3	243.8
1986	Director of broker	1.2	2.5	0.8	49.1	1.5	2.8	2.6	179.4
1986	Other working	0.7	3.2	0.5	61.6	1.4	3.5	2.5	220.3
1986	Relations	5.6	5.9	3.9	114.7	6.1	5.7	10.7	365.8
1986	External	90.0	85.1	62.7	1649.3	88.0	84.2	154.9	5367.8
1987	Director of agent	2.7	3.7	1.7	66.4	2.9	3.7	6.6	289.0
1987	Director of broker	1.4	3.2	0.9	58.4	1.4	2.9	3.1	225.1
1987	Other working	1.1	4.0	0.7	73.4	1.4	3.3	3.2	256.0
1987	Relations	7.6	6.2	4.8	111.8	6.7	5.9	15.3	456.3
1987	External	87.1	82.9	54.5	1506.9	87.7	84.1	199.9	6498.1
1988	Director of agent	2.7	3.8	3.2	129.4	2.8	3.7	9.4	400.9
1988	Director of broker	1.7	3.0	2.0	100.2	1.4	2.9	4.7	311.0
1988	Other working	2.0	3.9	2.4	131.1	1.6	3.4	5.5	364.8
1988	Relations	6.3	6.2	7.5	208.2	6.6	6.1	22.5	650.2
1988	External	87.3	83.2	103.4	2813.9	87.6	83.9	297.6	9001.5
1989	Director of agent	2.0	3.4	1.0	34.9	2.7	3.8	9.6	393.8
1989	Director of broker	0.8	2.2	0.4	22.4	1.3	2.7	4.8	282.6
1989	Other working	1.9	4.4	0.9	44.2	1.6	3.5	5.7	359.3
1989	Relations	5.6	5.9	2.6	60.4	6.3	6.1	22.7	629.8
1989	External	89.7	84.1	41.9	853.6	88.0	83.8	314.6	8630.5

**APPENDIX C.4 (continued)**  
**Analysis of LMX loss review syndicates**

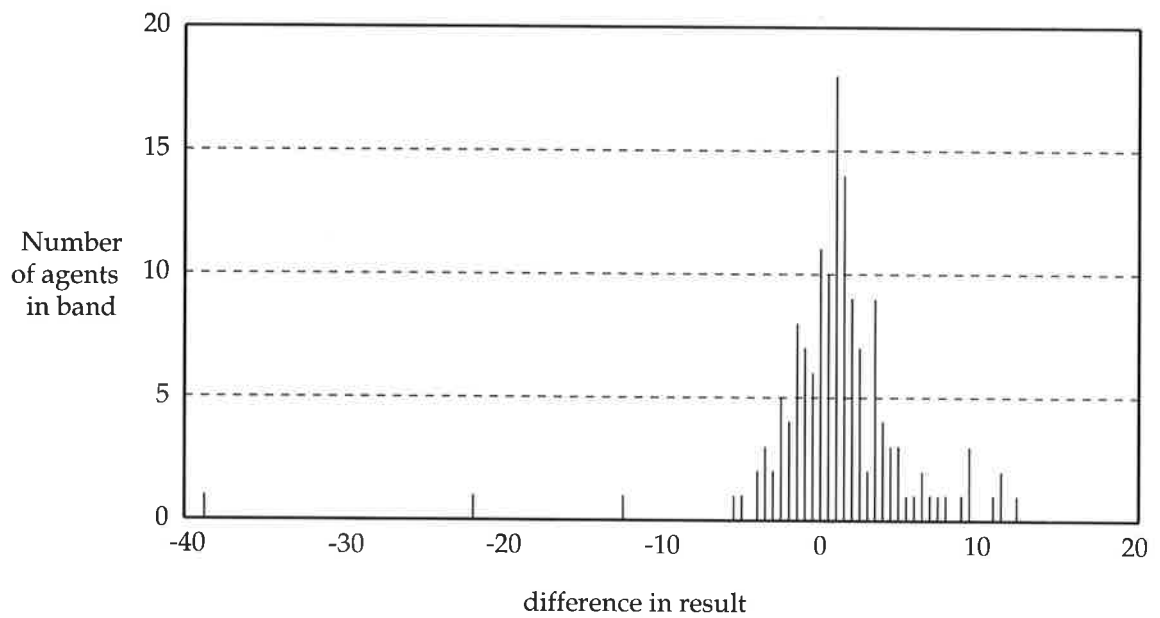
**Allocation of capacity and new capacity to LMX loss review syndicates  
compared with the whole market**

Underwriting year	Category of name	New capacity				Capacity			
		Spread		Amount		Spread		Amount	
		Loss Review	Whole Market	Loss Review	Whole Market	Loss Review	Whole Market	Loss Review	Whole Market
1990	Director of agent	2.6	4.0	0.8	53.4	2.7	3.9	7.0	402.2
1990	Director of broker	0.4	2.4	0.1	31.9	1.0	2.5	2.7	256.1
1990	Other working	1.1	3.6	0.3	48.4	1.6	3.4	4.1	351.1
1990	Relations	6.7	5.9	1.9	80.3	6.4	6.1	16.4	623.8
1990	External	89.2	84.1	26.1	1135.3	88.2	84.0	224.5	8578.0
1991	Director of agent	3.4	2.9	0.3	56.8	2.5	3.5	1.8	356.8
1991	Director of broker	1.8	2.1	0.2	41.3	1.0	2.2	0.7	228.7
1991	Other working	3.0	2.4	0.3	47.1	1.7	2.6	1.3	270.5
1991	Relations	6.0	6.3	0.6	123.2	6.2	6.5	4.5	664.5
1991	External	85.8	86.3	8.5	1685.3	88.5	85.1	63.5	8708.0

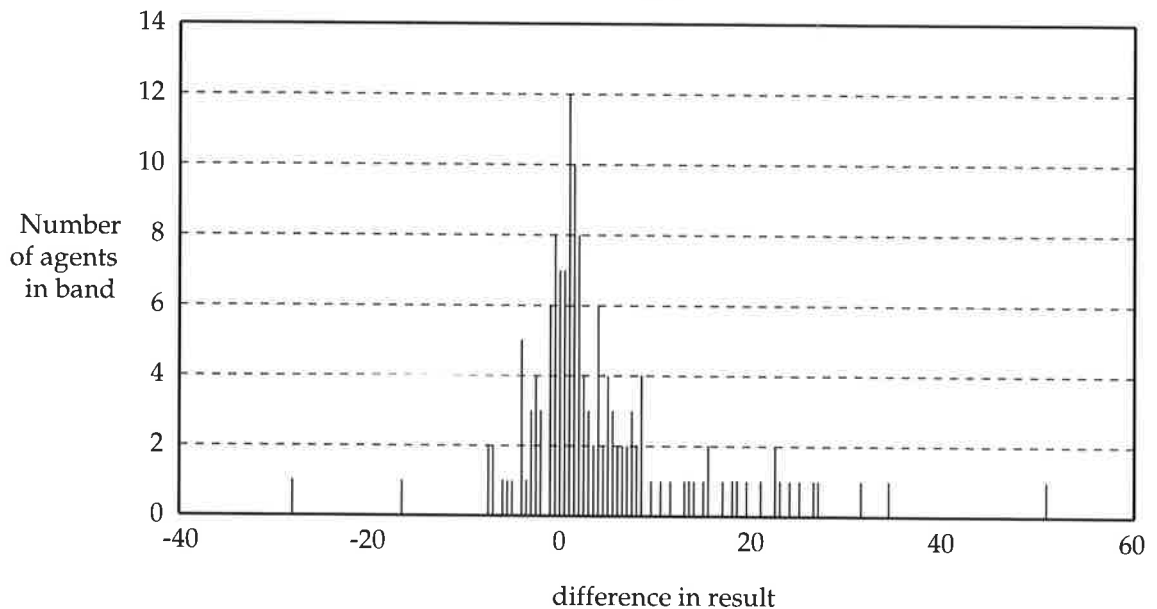
**APPENDIX C.5**  
**Difference in result between directors and  
non-working members for each agent  
1987**



**APPENDIX C.5 (continued)**  
**Difference in result between directors and  
non-working members for each agent**  
**1988**



**Difference in result between directors and  
non-working members for each agent**  
**1989**



## Appendix D Explanation of some specialist terms

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<b>Proportional reinsurance</b>	A type of reinsurance where the ceding company cedes to its reinsurer a predetermined proportion of the liability and premium of those policies subject to the reinsurance agreement.
<b>Non-proportional reinsurance</b>	A type of reinsurance which responds according to the amount of loss suffered by the reinsured after a specific loss amount retained by the reinsured for a premium established by the reinsurer.
<b>Excess of Loss reinsurance</b>	A type of reinsurance which provides cover for a loss event once the cost of the loss event exceeds a money sum specified in the policy. The cost of the claim below this point, known as the excess point will be reinsured, or reinsured by other reinsurers.
<b>Excess Point</b>	The money amount stated in an excess of loss policy above which that policy will begin to respond to claims.
<b>Retention</b>	The amount of a claim from a loss event which a reinsured would retain net for his own account, that is to say he would not be covered by reinsurance for that amount.
<b>Co-reinsurance</b>	A condition sometimes to be found in London market excess of loss policies that a proportion of the amount covered by the policy must be retained unreinsured by the ceding reinsurer (the reinsured). A figure of 10% is commonly used in the non-marine market.
<b>Exposure</b>	The maximum amount of loss which can be sustained under the terms of an insurance or reinsurance policy.
<b>PML (probable maximum loss)</b>	The underwriter's assessment of the maximum amount to which the insurer expects to be exposed by any one loss event, often expressed as a percentage of the total aggregation of exposures.
<b>Loss review</b>	An independent review commissioned by The Council of Lloyd's into the circumstances giving rise to large losses or deficiencies as defined in Lloyd's Loss Review Byelaw (No. 8 of 1991).
<b>Premium income monitoring</b>	The amount of insurance and reinsurance which a Lloyd's syndicate may underwrite is governed by the amount of premium income which it may accept in any one year. The maximum amount of premium income which a syndicate may accept is determined by reference to its capacity and premium income levels are monitored accordingly.