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Session 32PD
Lloyd's of London: Does It Have a Future?

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Summary: This session takes a hard look at Lloyd's of London, examines how it has reached its current state of affairs, and examines its future. Topics include:

- *How Lloyd's works*
- *What went wrong?*
- *The role of Equitas*
- *The impact of corporate capital*
- *The future outlook for Lloyd's*

Mr. Gerald Kopel: The reason I set this session up is because I don't think very many of us here have a great knowledge of Lloyd's and how it has gotten where it is, or what it does. So we have three individuals who are going to speak on this subject. Denis Loring is a senior vice president with Equitable Life in New York City. He's responsible for all reinsurance and related activities including ceded financial reinsurance and the assumed line of business. Denis received his AB from Harvard and his MS from MIT, both in mathematics. He's a FSA, a member of the AAA, a member of several industry groups on reinsurance, and a former chairperson of the Reinsurance Section of the Society.

†John Mulhern, not a member of the sponsoring organizations, is counsel at LeBoeuf, Lamb, Greene & MacRae in New York, NY.

Our second speaker is Mr. Jim Wertheimer. He's a vice president and corporate actuary at UNUM Corporate in Portland, Maine, responsible for the provision of actuarial advice to UNUM Corporate, senior management and for providing leadership to actuarial personnel across the UNUM Enterprise. UNUM was the first insurance company to invest in Lloyd's, on a corporate basis, through its purchase of the Trafalgar Agency, which manages nonmarine syndicate 1101.

Our third speaker is John Mulhern of LeBoeuf, Lamb, Greene and MacRae. John is counsel at the law firm of LeBoeuf Lamb, which has served for many years as the U.S. general counsel to the underwriters at Lloyd's. John earned his B.A. from St. Johns University in 1979 and his J.D. from the University of Illinois in 1982. He has spent much of the last 14 years working with the Lloyd's market and representing that market in the U.S.

Denis will initially talk about how Lloyd's works and its history, and how it got to where it is. Jim will then discuss the role of corporate capital, and then John will tell us what Lloyd's thinks about what's going on now and where it will be in the future.

I would like to point out that opinions expressed as to the future of Lloyd's by Denis and Jim are their own, not necessarily those of their companies. John, of course, is the representative of the Lloyd's market.

Mr. Denis W. Loring: I'll be giving you a brief explanation of how Lloyd's works by taking you through the first 300 years of its history, and explaining the current crisis.

Lloyd's began in the 1680s as a coffeehouse. I mean that literally: Edward Lloyd's Coffee House. Edward Lloyd was not a risk-taker, and although some of you may not realize it, Lloyd's is not a risk-taker. Edward Lloyd provided a place to do business, a news-gathering and information center, some facilities where people could transact business, and that coffeehouse became a center of insurance activity. It moved a couple of times as it increased its business, and that entity eventually became Lloyd's. In 1871, there was a Lloyd's Act of Parliament that created the Corporation of Lloyd's.

Lloyd's cruised along until the mid-1980s, and then ran into a few problems, as we will see. From 1993–96, 300 years later, we have what I will call the creation of the new Lloyd's. There's a 1993 business plan, the 1994 introduction of corporate capital, and in 1995, a document called "Reconstruction and Renewal."

First, let's take a look at how Lloyd's works. The most important thing to realize is that Lloyd's is not a risk-taker. Lloyd's is a marketplace. In many ways Lloyd's is to the insurance industry what the New York Stock Exchange is to stocks. It's a place where buyers and sellers of risk get together. Now the buyer of risk is anyone who wants insurance. But a buyer cannot approach the Lloyd's market on his or her own. Instead, he must go through a registered Lloyd's broker.

Who actually bears the risk? Up until the introduction of corporate capital, risk was borne by individuals: single human beings just like you and me. They were called names. Each name functioned like a little insurance company. Names band together in groups called syndicates. Names have member's agents, to oversee their affairs, and syndicates have managing agents to oversee their affairs. Lloyd's is the place where they meet. Lloyd's is a huge room consisting of many floors with many boxes. Underwriters for the syndicates sit at the boxes, while brokers run around from box to box carrying risks. The broker sits with an underwriter, describes the risk, describes the coverage, and tries to negotiate a rate. When they agree, the underwriter binds the coverage for the syndicate. The broker then goes on to other underwriters until the risk is fully placed. The syndicate is backed by its individual names, each one of which has subscribed for a certain amount of premium, which will translate to a certain percentage of the risk. In actuality, it is only the name, the individual, who is taking the financial risk.

One very famous feature of Lloyd's (again, all of this is until the introduction of corporate capital) is that when you sign up as a name, you sign up for what is called 'unlimited liability.' To the horror of most people, this is exactly what it sounds like: "down to your last cuff link." Let's say you've given a syndicate £25,000 premium limit. If it has a 200% loss ratio, you lose £25,000 (excluding expenses). If the loss ratio is 300%, you lose £50,000. What if it's 2,000%? If you think this is impossible, there is one syndicate whose loss ratio dropped from 700% to 1,000% in just this past year. Simply put, you are liable for everything you own. To become a name at Lloyd's, you must put up some funds in advance. It can take that, it can take your house, it can take your car, and even death does not save you, because it can go into your estate. Unlimited liability means exactly that.

So what exactly does Lloyd's do? Lloyd's provides an operating structure, a clearinghouse, support services, centralized management, and just as it did in the 1680s, it provides a place for all this to take place.

Lloyd's has four main sectors: aviation, motor, marine, and nonmarine. Aviation includes commercial aviation, general aviation, and aviation products and satellites. Lloyd's has about 30% of worldwide aviation business. Motor is exactly what it sounds like: regular autos, fleets, specialty cars. Lloyd's has about a 17% market share of the U.K. market. Marine, of course, is the coverage that Lloyd's started out with. It began insuring ships. Lloyd's insures hulls, cargo, transport, and marine structures, such as offshore oil rigs. There was one called Piper Alpha that we'll get to later. Lloyd's has about a 16% share of the world marine market. Nonmarine is the largest market sector, and it's also the one that most people might think of when they first think of Lloyd's: It would insure Betty Grable's legs or Fidel Castro's beard. It will insure just about anything in the specialty market. But it also does life, accident and health, and employee professional liability, as well as the specialty coverages.

Since 1990 Lloyd's worldwide premium has increased about 30%. So even through these troubles, the premium at Lloyd's still grows. As you might imagine, Lloyd's largest market is the U.K., and its largest overseas market is the U.S.

LOSSES

What has been happening at Lloyd's? You've heard much talk about huge losses. Where are they coming from? There are three main sources.

Asbestos is often in the news. This is a long-tail business. In other words, the risks may actually come home to roost many years after the coverage is placed. The general liability wording for a lot of Lloyd's coverages was extremely loose, and, of course, whenever possible, U.S. courts will interpret any sort of loose wording in favor of the policyholder, and against that very, very deep-pocketed company. Remember, though, that the deep-pocketed company called Lloyd's is actually a bunch of individual people called names. So you can argue that all the courts are doing is taking money out of one group of individuals' pockets and putting it in another. But we won't get into that.

There is also something called the "losses occurring versus claims made" question. What that means is, when a loss occurs, who pays? Let's suppose I bind a coverage today, a loss event (like pollution) occurs tomorrow, and a claim is made 40 years from now when the insurers are different. Who is on the hook, the insurer when the loss occurred, or the insurer when the claim is made? Obviously insurers 40 years ago couldn't even contemplate some of the risks that are involved today, and certainly couldn't envision the rulings of the courts.

Environment and pollution—same thing. A 1980 congressional act said, "Clean it up, no matter what it costs. Somebody will pay, don't worry about it." There go the names again. And, again, the U.S. courts interpreted the policies liberally. Also, the U.S. general liability carriers reinsured many of their risks into Lloyd's. They get stuck with the cleanup bill and they pass it on.

Finally, you have catastrophes and the spiral. What is the spiral? Suppose I insure a risk. I then reinsure part of it to syndicate A and part of it to syndicate B. A has an excess of loss cover on its portfolio placed with syndicate C and syndicate D. Syndicate C has a stop-loss cover placed with A and E, and some of it with me. And I, of course, have a stop-loss protection on my syndicate and I reinsure some of it to B, some of it to C and some of it elsewhere. What happens if there’s a loss? I pay. I recover. A recovers. C’s stop-loss is triggered: time to recover. From E, from me—oops! My loss has just increased, time to recover, from A, from B, then A from C and the spiral spins and spins.

Unfortunately, somebody forgot that if you have £8 billion of losses and keep passing them around, somebody at the end pays £8 billion of losses. Plus, every time the spiral spins a broker takes out 10%. It’s just like playing poker in Las Vegas, where the house takes a little chip out of every pot. Play the game long enough and there won’t be any chips in the pot for any of the players. The house will take them all.

Admittedly Lloyd’s became unlucky. Remember I mentioned Piper Alpha, an oil rig in the North Sea. It went down, and it started a run of catastrophes absolutely unprecedented in the history of Lloyd’s. There’s a term in the nonlife insurance business called probable maximum loss (PML). It’s the number that nonlife insurance companies use to figure their aggregate exposures. The PML for a Florida hurricane was deemed to be about $2 billion. Then Hurricane Andrew came along.

What effect has all this had on Lloyd’s financial results? Over its 300 years, Lloyd’s has actually been quite profitable. In fact, in modern times, over many decades, Lloyd’s has averaged about a 15% annual return. From 1967 to 1987, it had 21 consecutive profitable years, which is a pretty good track record. Then came Piper Alpha and its friends. Boom! From 1988–92 you have losses of £8.1 billion. That’s a very large sum of money.

What effects did those losses have? Predictable ones. In 1968, there were about 7,000 names. Remember, names are the individuals who actually bear the risk. Names were primarily wealthy individuals, landed gentry, and some members of the English royal family. Being a name was deemed to be a prestigious and honorable thing. Then Lloyd’s started its run of profitable years, and more and more people said, “Hey, this is a neat game. I can put up some money, like my IBM stock, which is unencumbered, let it sit there earning dividends and it can still bring me an extra 15% on top of that.” Also, some of the brokerage houses in the early 1980s were awarding or making available to their employees the ability to become a name at Lloyd’s, and by changing some requirements, they only had to put up a minimal amount of money. The number of names absolutely exploded until 1988.

What was 7,000 names in 1968 grew to 32,000 names in 1988. Then came the losses and look what happened—from 1988 to 1995, the number of names has dropped by more than 50%, as has the number of syndicates. The capacity of Lloyd's, however, declined a comparatively small amount. You had more risk being borne per name. Then, in 1994, we saw the introduction of corporate names. In 1995, corporate capital represented only 1% of the syndicates, but 23% of the market's capacity.

The question on everybody's mind now is, Can Lloyd's survive? It has all of these losses; where is it going to get the money to pay them? When you are a name, all your premium income goes into a trust fund. There are the Lloyd's American Trust Fund, the Lloyd's Canadian Trust Fund, and the main overseas Lloyd's Trust Fund. You don't simply pocket your premiums and then hope to pay your claims later. Those trust funds at the end of 1994 had a little over £20 billion in them, so there's some money there. Next, you have "Funds at Lloyd's." If you are a name, you have to deposit certain funds with Lloyd's. It can be in cash, a letter of credit, marketable securities, and so forth. The amount of premium that you're allowed to write is based on the amount that you deposit. All of those funds, about £5.1 billion, are sitting at Lloyd's.

Remember "down to your last cuff link"? All the personal wealth of all the names is theoretically at risk and available to pay claims. That amounts to about £1.5 billion. It should be noted here that in its entire 300-year history, Lloyd's has never, I will repeat, never paid a claim at less than 100 on the pound. It has paid every claim to every penny so far.

There is also a Lloyd's central fund. A very small portion of all the premiums go into the central fund, just in case something goes wrong or there has to be some sort of central backing; that's about £0.7 billion. Finally, Lloyd's itself has assets, its own structures, and that has about £0.3 billion.

If you add all of these sources up, it's £27.7 billion. The current estimate of future liabilities, as of the end of 1994, was £21.1 billion. By subtracting, we find £6.6 billion of surplus. In other words, there's plenty of money to pay.

These figures are on what we might call a statutory basis. In the U.S., you have something called cash-flow testing. If you look at the cash-flow testing of Lloyd's, the situation may not be so rosy. Specifically, not all of those funds are as available as Lloyd's might like. As I'm sure you've read in the paper, many of the names don't want to pay; we were robbed. It was OK when we were earning 15% profit over the last 30 years, but now we're suddenly having losses. We were sold a bill of goods, and we don't want to pay. There are a number of cases in U.K. courts right now with names that are simply refusing to pay. These names are suing their underwriters, managing agencies, member agencies, and anybody else they can find. A number of entities have tried to sue in the U.S., but there's a clause in their contracts that says that all suits have to go into the U.K. So far this clause has proved to be bulletproof.

And, of course, you have bankruptcies. Some names are on syndicates that went so bad that these names are literally bankrupt. In other words, these names are "can't pay" as opposed to "won't pay." So what happens? There's a settlement offer, and a new entity called Equitas, which will be the ultimate reinsurer for all 1992 and prior liabilities for all names. The hope is that Equitas will solve the problems once and for all, and you then will have the renewed and reconstructed Lloyd's.

Mr. James L. Wertheimer: I'm going to talk about corporate capital, which Denis alluded to in his remarks. I'm going to discuss:

1 Origins of corporate capital at Lloyd's
2. Impact on individual names
3. Responsibility for problems of the past
4. Recent developments
5. Risk-based capital (RBC)
6. Future of corporate capital

ORIGINS OF CORPORATE CAPITAL

Historically, underwriting at Lloyd's has been limited to individuals, who act as "sole traders," assuming liability severally, but not jointly, on insurance risks accepted by the underwriter of a syndicate. Sole trader status prevents investors from limiting their liability. Lloyd's had always believed that its structure meant that its capital providers could only be individuals who accepted unlimited liability.

However, as Chris Hitching of Union Bank of Switzerland said in his 1993 report, "Hanging, of course, concentrates the mind, and, in the spring of 1992, facing unprecedented losses, Lloyd's investigated and learned that, owing to a misdrafting of the 1982 Lloyd's Act, there was no legal barrier to it managing incorporated vehicles alongside its traditional individual names."

In April 1993, the business plan was released, which signaled the basic framework for the introduction of incorporated investors for the 1994 underwriting year. Lloyd's said, "The presence of professional investors will generate confidence among clients; and the disciplines of intense scrutiny, cost control, quality management, and information provision will enhance the profitability of syndicates to the benefit of all."

A consultative document on corporate membership issued in July 1993. In September 1993, corporate capital guidelines, "A Guide to Corporate Membership" were issued. In October 1993, an extraordinary general meeting approved the introduction of corporate members. Essentially, corporate vehicles must be dedicated to Lloyd's, with no other activities other than incidental ones, such as investment.

Several months later, in January 1994, 25 corporate members started underwriting and provided £900 million of capital, which translated into £1.6 billion of premium or 15% of total capacity of £10.9.

In 1995, corporate had 23% of capacity; in 1996, 31% of capacity; and in 1997 corporate is expected to provide 47% of capacity.

As one can see, the capital structure has changed substantially over the last three years. One can see the increasingly important role corporate capital is providing.

What is the reason for this growth in capacity, and why was it so important for corporate capital to take on this increased role at Lloyd's? Very simply, in order to effectively compete in the future, Lloyd's needed to ensure that capital could be attracted to replace the capital that could be withdrawn by names who had been adversely affected by the losses experienced in prior years.

There has been a concern at Lloyd's that capacity may decrease, given the problems of the past. Names have been wiped out, and it is expected that direct participation by names will decline. The introduction of corporate capital has been a significant initiative to offset the decline in capacity provided by names. In other words, the risk of Lloyd's being unable to attract sufficient capital to conduct its business was precisely the risk that led to the introduction of corporate capital.

IMPACT ON INDIVIDUAL NAMES

Nevertheless, while corporate capital has been an important and increasingly significant source of capital to the markets, the resiliency of names continuing to participate in the markets appears to have surprised everyone at Lloyd's.

There is also a shift in the way individual names are participating. Given the problems of the past, individual names are more often participating in the market through what are known as Members Agents Pooling Arrangements (MAPA). One could think of these as operating like mutual funds, where the fund invests in a broad array of syndicates to diversify the risk to the individual names investing in the MAPA. One advantage of a MAPA is to allow names to participate with funds-at-Lloyd's-to-premium ratios of 25%. For 1994, over 12,000 names underwrote via the MAPA route. In 1996, MAPAs provided about 25% of Lloyd's capacity, compared to about 45% for bespoke names and 30% from corporate.

In May 1995, Lloyd's published a document titled "Reconstruction and Renewal." This announced a plan for individual names to move to some form of limited liability vehicle in the future, once the regulatory aspects could be worked out.

According to Lloyd's List Insurance Day, names are looking forward to limited liability capital vehicles. It is possible that MAPAs could become incorporated. In the meantime, names currently have right of tenure on syndicates, meaning that they cannot be forced to give up their share of underwriting. Also, they have right of preemption on any increases in syndicate capacity.

Prior to the summer of 1995, it was not possible for a name to put a value on one's right to underwrite part of the risk on a syndicate. One simply got in line for what was hoped was a good syndicate and took a position when one became available. Members agents had enormous power in getting members access to the "good" syndicates.

Here's how it worked: a syndicate perceived to be attractive attracts a queue. Consequently, members of that syndicate are likely to have been members of Lloyd's for some time in order to have moved up the queue. As Chris Hitching said, it was easy for a managing agent to figure out which syndicates to pick. The good ones have a long queue; the bad ones buy him expensive lunches.

Last summer, for the first time, it became possible to trade one's participation in a syndicate. According to a publication called *Reactions*, in an article titled, "Lloyd's Corpse," auctioning of members' syndicate participation rights in 1995 resulted in £250 million of capacity changing hands, on 99 syndicates. The total value of these rights was £4.2 million.

This development is great for names who want to get out of Lloyd's and realize something in the process. It is not so good for Lloyd's, in that the old system ensured a continuity of capital for the syndicates by ensuring that names would be very reluctant to quit and give up their position unless the future prospects were particularly dreadful. This meant that Lloyd's capital base was usually sustained during difficult times.

The auctioning of members' syndicate participation rights was made possible only because of the availability of corporate capital to fill the gap as individual names auctioned off their participation.

RESPONSIBILITY FOR PROBLEMS OF THE PAST

One of the greatest concerns of corporate capital providers is to be insulated from the problems of the past. Equitas is designed to place a "ring fence" around the problem years. Nevertheless, there is a risk that the Lloyd's central fund may be insufficient, when all is said and done.

It is important to recognize that new capital is ultimately exposed to the old years; should claims deteriorate such that Equitas requires new capital, it must come from the central fund and, ultimately, from future generations of capital providers.

In May 1995, in the "Reconstruction and Renewal" document, it was estimated that all members, including corporate capital, will need to provide contributions totaling £450 million. This will come from a charge of 1.5% of capacity for the 1993, 1994, and 1995 years of account. The contributions will be offset against future central fund contributions, and Lloyd's promised that there would be no future levies for the 1992 and prior years.

Jonathan Agnew is the chairperson of the London Insurance Market Investment Trust (LIMIT). This is the largest corporate capital vehicle today. Agnew says that corporate capital will fund about £160 million of Lloyd's debt.

CURRENT DEVELOPMENTS

According to Lloyd's "Reconstruction and Renewal" document from May 1995, four key liberalizations were introduced to further encourage corporate investment at Lloyd's:

1. Integration of corporate members and managing agencies was permitted
2. Conversion from traditional to corporate syndicates was encouraged
3. Limitations on the capacity to come from corporate capital were lifted
4. Insurance companies were free to acquire an interest in a managing agency.

When corporate investors were first permitted at Lloyd's, they could only own 25% of a managing agency. On June 30, 1995, this was moved up to 100%. However, an insurer cannot own a managing agency unless it also has a substantial participation on each syndicate managed by that agency.

UNUM Corporation was the first insurer to acquire a managing agency when it bought the Trafalgar agency, manager of Syndicate 1101, last December.

In total there are 167 Lloyd's syndicates in 1996, versus 170 in 1995. There are 20 corporate syndicates, up from only five in 1995.

The largest new corporate vehicle this year is the Brockbank/Mid-Ocean deal. Brockbank is a managing agent with £411 million of premium in 1996. It is the sixth largest managing agent at Lloyd's, where the largest has about £700 million of premium. Mid-Ocean is a reinsurer with $1.3 billion of capital. Their new vehicle provides £50 million of capital with an overall premium limit (OPL) of £100 million. The next largest new vehicle has only about £25 million of capital. In the future, it is expected that units with £100–200 million of capital will be developed.

Another new development, according to a publication called *Capital News,* is that beginning this March, broker groups at Lloyd's are allowed to own managing agents. These groups must, however, have a 15% minimum interest in the aggregate capacity of the syndicates managed by the agency. Otherwise, it was feared that the brokers would steer their clients to these syndicates without any care for how well they actually did.

CAPITAL FOR CORPORATE INVESTORS: RISK-BASED CAPITAL (RBC)

One of the differences between corporate investors at Lloyd's and members is the corporate investor's lack of patience. Corporate investors will want faster and earlier reporting of results. Thus, Lloyd's is moving from a three-year to a two-year reporting period so that the investors in corporate vehicles can place a value on their investments.

Similarly, investors in corporate vehicles will want to know how to gauge their return on their investment. The corporate vehicle needs to know how much capital they need to hold and what kind of returns they should expect. It is generally agreed that (1) it is better to write a mixed portfolio of risks and (2) it is better to be spread across several agencies rather than one.

In August of 1995, Lloyd's published its first in-house study of RBC. This "Consultative Document" developed a methodology that is to be used on an indicative basis for 1996 and is mandatory for 1997.

The RBC system is designed to show what level of funds-at-Lloyd's should reasonably be expected to meet a member's liabilities. The amount of those funds is calculated by reference to the volatility of each type of business in the member's portfolio.

The RBC system has been developed such that the overall capital base of the Society remains unchanged. It would, however, change the way in which the present amount of capital supports the business. Some members will find that they require higher levels of funds-at-Lloyd's, if higher risk business predominates in their portfolios. Conversely, members with lower risk portfolios could ultimately find their fund requirements reduced.

Keep in mind that corporate investors at Lloyd's are highly leveraged. Lloyd's requires funds-at-Lloyd's to be 50% of a member's RBC. Funds-at-Lloyd's can be further leveraged, in that only £1.5 million needs be in cash (£750,000 for non-U.S. investors). The balance may take the form of a letter of credit. Return of capital (ROC) and return on equity (ROE) performance can improve substantially by the use of this leverage.

Prior to the consultative document, Lloyd's had not assessed or regulated their capital base by reference to risk exposures. However, they recognized that there has been a general trend in the direction of risk weighting of capital across the financial sector, with the U.S. regulatory authorities setting the pace for the U.S. insurance industry, and the Office of the Superintendent of Financial Institutions (OSFI) and CompCorp for Canada.

THE ADVANTAGES OF RBC FOR LLOYD'S

For members, the introduction of the RBC system would provide more information as to relative risk levels of specific classes of business. They would then be able to make more informed assessments about how their portfolio should be diversified for a given level of available funds-at-Lloyd's. The RBC system could also serve to focus their minds on the risk/reward ratio of membership.

For Lloyd's, RBC would enable better informed decisions to be taken as to the level of capital required to be provided by members, by aligning the capital base (that is, members' funds-at-Lloyd's) more closely to the types of business that are being written. By matching the level of funds required to the intrinsic volatility of the business it supports, Lloyd's would be able to manage more effectively the potential cost to the central fund of members who are unable to fund their losses.

Managing agents would have access to an additional source of data, which could enhance their own information and monitoring systems, enabling them to identify the impact of their book of business on their supporting capital. If a particular category of business demands more capital to support it, it should be capable of producing demonstrably better returns. With the advent of large corporate capital providers who are likely to be more rigorous in their demands for satisfactory returns on capital employed, this is very important.

According to the consultative document, every insurer faces three general types of risk, which create the need for capital:

1. The risk that obligations to policyholders will be greater than expected (what we call C-2 risk)

2. The risk that assets supporting the insurer's obligations will not be realizable at their expected values, perhaps because of a decline in the market values, defaults on investment or nonperformance by creditors (our C-1 and C-3 risks)

3. The general business risk faced by all enterprises that their competitors will gain advantage or the employees will behave dishonestly or incompetently (our C-4 risk).

The Lloyd's RBC project concentrated on the first of these three categories, that is, policyholder obligations or the C-2 risk. Asset risk and the more general business risks have not been addressed.

A member's RBC requirements would be calculated in three stages:

1. Reference is made to the type of business underwritten by each of the syndicates in his portfolio

2. A "credit" would be given to the extent that the business written by all those syndicates taken together is diversified

3. A further credit would be given for the extent to which the member's portfolio has diversification of management.

When fully developed, the RBC system may add certain other factors related to prudent management and reinsurance, which are still to be assessed in detail.

The diversification credits will serve to encourage a spread of business, because diversification has a more beneficial effect on a member's capital requirement than complete avoidance of high-risk business. Since Lloyd's has traditionally succeeded by writing a spread of high-risk/high-return business, these diversification aspects are extremely important.

The first task was to define the classes of business on which the system should be based. The business underwritten at Lloyd's covers a vast spectrum, but the key was to separate that business into classes with discernible differences in risk profile. The classes needed to be well defined so as to prevent manipulation but, above all, must be practical in relation to the availability of data.

Initially, the intention was to consider only 20 risk categories, corresponding to the solvency categories for which syndicates provide data to Lloyd's. It was soon clear, however, that the classes of business used for solvency purposes at Lloyd's were too broadly based to provide an adequate classification of the business underwritten by the syndicates.

The formulas, therefore, are presently based on risk codes, which represent the most detailed analysis of business that is commonly used in the market. In many cases, however, sufficient credible data are not even available at this level to rely purely on analytical techniques. Consequently, there has also been subjective input from various experts.

The system operates on the basis of Lloyd's 97 different risk codes, examining the specific characteristics of each type of business in deriving the percentage charge associated with each code.

During the course of developing the system, it became clear that, while some risk codes are very specific, others cover a broad range of businesses, not all of which have the same risk characteristics. It has been suggested that, in these cases, new risk codes should be introduced to ensure that the capital charge associated with each code is appropriate for the business to which the code is applied. For example, nuclear business is currently included within the code for property damage liability.

Lloyd's is willing to have corporations come to them and make representations as to what the RBC should be for a specific class of business. My company has tried to do just that. Our syndicates write "personal accident" business, which covers a fairly wide spectrum of risk. This ranges all the way from relatively low-risk pure personal accident and medical expense coverage to the somewhat more volatile and high-risk London Market Excess (LMX) business.

Our own analysis indicated that the risk from the high-risk business was at least five times the risk on the lower risk business. Lloyd's assigned all of these to the same risk class, with the same capital requirement of 94.8%. Furthermore, our business is grouped with categories such as agricultural crop and forestry, energy onshore, and hail insurance. This tends to weaken the credibility of the scientific basis on which the factors were developed.

At UNUM, we performed our own analysis of the risks to be written at our Lloyd's syndicates. We developed a ruin theoretic model to determine the appropriate risk capital requirement as a percentage of premium that would prevent insolvency at a 99% statistical confidence level. This indicated that our lowest risk business requires about a 49% capital level, and the highest risk, an 82% level, both lower than the 94.8% suggested by Lloyd's.

The RBC system at Lloyd's, nevertheless, is a welcome addition to those already in place, specifically in the U.S. and Canada. The RBC system moves the discussion to a more scientific basis. The consultative document identifies the issues thoroughly, describes in adequate detail the approach taken to develop the proposed system, and is refreshingly candid in admitting some of the weaknesses of the proposal. I think we all agree that standards of capitalization for insurance risk-bearing entities would seem to be a minimum necessity, though not a sufficient requirement, to reduce the probability of failure.

FUTURE OF CORPORATE CAPITAL

The future of corporate capital at Lloyd's is still uncertain. One of the magical aspects of the old Lloyd's was that no one could add up the capital which stood behind the central fund. The secret of unlimited liability was not that liability was really unlimited, it was that no one truly knew the assets.

If Lloyd's becomes merely a series of insurance companies, that will change irrevocably. Insureds and analysts will know the assets. The secret of Lloyd's past success—the perception that it was backed by the untold combined wealth of the gentry of old England—will disappear.

Mr. John Mulhern: Does Lloyd's have a future? I'd like to talk very briefly about a snapshot of the Lloyd's market as I think it exists in late May and early June of 1996. I think that this is the prototype of the Lloyd's of the future, and it will give you an idea of where Lloyd's is heading. In very many respects, as you've judged from what Denis and Jim have had to say, Lloyd's is a very unique organization. If you come to it assuming that it's like an insurance company or an insurance corporation, you will never understand it.

One of the ways in which Lloyd's is unique is the fact that when you write a premium as an insurer or a name, you don't touch it. It doesn't come under your control. It gets locked into a trust fund and is held there for a minimum period of three years under Lloyd's accounting rules. That business that was written by the Lloyd's underwriters in 1992 was not actually closed out until 1995, which was the earliest that a name could actually get his or her hands on a profit for business written in 1992. Mechanically, the way it works is that the premium flows into one of a very complex series of trusts; that alone is a topic for a full day of discussion.

However, you then go through a series of interim accounting after the first, second, and third years; you go into a transaction that's known as reinsurance to close.

What reinsurance to close is all about is determining how much it's going to cost to run off the business that was written three years ago and pay the losses in full, plus pay a reasonable premium to the following underwriters that will take the responsibility for running it off. The premium is called reinsurance-to-close. Any funds left in the trust deposits after reinsurance-to-close premium is paid is finally distributed to the underwriters three years later. That is the way that the Lloyd's accounting system currently works. As Jim indicated, that's currently in the process of review and perhaps being shortened. Historically, it is still the three-year accounting system.

These facts are important to keep in mind because the press reports tend to look at Lloyd's not as it exists now, but as it existed three years ago. I think that will give you a distorted picture of what Lloyd's is all about in 1996 heading into 1997 and beyond. I'd like to review that with you. I will spend most of my time talking about what everybody wants to talk about, which is Equitas, reconstruction and renewal, and the securities litigation—these are on everybody's list of things to talk about.

Let's take a brief snapshot of Lloyd's as it exists. As Denis has indicated, not too many years ago there were 400 trading groups, called syndicates, at Lloyd's. That number has now shrunk to less than 170. You see a substantial reduction in the number of syndicates that are writing business on behalf of names. At the same time, it's important to note that the capacity has remained stable. What that says to me is that there has been a real concentration of the Lloyd's market into more efficient trading units. The people that are getting the better results are the people still in business. Those with the less desirable results have had trouble drawing capacity to their syndicates and have had to retire, and I think that's a trend that you're probably going to see going on into the future.

The 1996 stamp capacity for the Lloyd's market in its entirety is running at about £10 billion sterling. That translates to a little over $15.5 billion U.S. So not only is there no capacity shortage, but some people have commented that there may be too much capacity in the Lloyd's market. Much of that capacity is coming from corporate names, as Jim has indicated to you. That trend is probably going to continue. It's interesting to me personally to note, in light of all the adverse press and the losses, that much of the new capacity is also coming from the traditional names, the natural people, who were underwriters, who want to continue to trade are increasing their lines of participation in the Lloyd's market.

If you're reading the press, you read about all the red ink, and you might wonder why is it that the capacity is staying in Lloyd's? Why are corporate names lining up to join the market? Why is it individual names are increasing their participation? It doesn't seem to make sense in light of what you've been told. The answer is, there's a lot of money to be made at Lloyd's. Lloyd's is still a unique organization. In my own opinion, it still does leadership underwriting, unusual underwriting, and cutting-edge underwriting better than anybody else in the world. You still have that core of imaginative insurance professionals in the London market. And the fact of the matter is, over the last three years the results have really been quite good, something that has not been noted much in the press.

The independent agency that comments on the Lloyd's market estimated that the profits for 1993, currently in the process of being closed out, will be ranging a little over £1.08 billion sterling. This translates to a profit in U.S. dollars of $1.66 billion. The preliminary numbers of 1994 are in excess of $1.55 billion. The preliminary numbers for 1995 are profit in excess of $1.4 billion. Over the last three years the total profit of the Lloyd's market looks like it's going to be in excess of $4.5 billion; that's a fair amount of black ink. And, as Denis has indicated, that goes along with a tradition, obviously severely interrupted for a period of five years, of profitable underwriting at Lloyd's. There is clearly money to be made at the Lloyd's market.

At the same time I think you're seeing a more professional Lloyd's; I think you're seeing a leaner, meaner Lloyd's, and also I think you're seeing a Lloyd's that is keeping the best of the 300-year tradition, but is actually realizing that it's about to burst into the 21st century and it's time to modernize many things. Much of it comes out of the Rowland report, which has been alluded to earlier by some of the speakers, and I won't go into it in any detail.

We are talking about a substantial improvement in the self regulation of Lloyd's. We're talking about the creation of the separate regulatory board, along with the market board, to sharpen and strengthen regulatory efforts. We're talking about introduction of RBC, which again is an imperfect concept, as we know, and a work-in-progress, but I think a very positive development. A whole variety of other issues are going on as we speak. We're here today to talk about Lloyd's, and I note that the title of the seminar is not "the future of Lloyd's," but "Does Lloyd's Have a Future?" There still has to be a question mark there.

Given the very positive trend that we've seen over the last three years, why is there still that question mark? We all know the answer to that. In 1992, Lloyd's went through what hopefully will be the last year of very severe losses. It can't be denied that a number of the underwriters suffered very terribly during that period of time. In the final analysis, the question is, will the new, profitable Lloyd's, the corporate name Lloyd's that is emerging, be dragged down and ultimately crippled by infighting resulting from old years of activity? We know from where the losses came—from asbestos, pollution, and manmade and natural catastrophes. Also, the

Lloyd's underwriters did write a great deal of U.S. liability business and that has come home to roost.

One anecdote came to mind when Denis was talking about the difference between the occurrence and claims-made policies. Back in the early 1980s, when I still did litigation, I was involved in a suit where I was defending Lloyd's in a coverage dispute on an occurrence policy allegedly written in the 1890s. Now the losses, as I say, have been severe. I think it's important to recognize that the people that were writing business in 1992 and prior years are all natural persons. They're all people much like you and I, although they have much more money than I do, but many of them have suffered very severe losses, and that can't be denied.

The reinsurance-to-close system, which I described when I started talking to you, requires that at the end of the third year, the projected cost of run-off must be calculable within a reasonable degree of certainty, so that the reinsurance-to-close premium can be calculated. What a number of the underwriters found is that they reached the end of year three and there was asbestos in the book, or that there might be pollution exposures in the book, or there are other long-tail exposures where the cost to run it off cannot be calculated. It was therefore not possible to calculate what the reinsurance-to-close premium would be. Therefore, the year had to be held open at the end of year three, and the end of year four, year five, year six, and so forth. The longer the tail of the business that's in the book, the more difficult it is to calculate the reinsurance-to-close premium.

What this means in terms of the impact in the real world on the natural person is that there are names who want to retire from Lloyd's. They did not have a good experience and they've lost severe amounts of money. They want to get out of the market, and they're finding that they can't. The reason is that they are not allowed to withdraw from Lloyd's until all of their liabilities are accounted for. And, if they are participating on a syndicate that has open years that they are unable to close (because they can't figure out what the cost of run-off is going to be), they're stuck in the Lloyd's market and can't get out. That has been a major source of contention among some of the disgruntled names and Lloyd's.

What are you going to do about losses suffered by some folks from 1988 to 1992? Denis gave a brief overview of the structure of Lloyd's. A number of the names felt that they were relying upon their member's agents to give them good, sound advice as to which syndicate they should participate in. They felt that their member's agents had not done a proper job for them.

They had put them on syndicates where they ought not to have been. At the same time, the names participate on syndicates. They felt that the folks running those syndicates (when deciding what risks the syndicates would take, what the terms and conditions would be, and what the premium would be) behaved negligently and exposed the names to greater losses than they ought to have been exposed. The names felt the syndicates were careless, allegedly, in business that they wrote. That basic dispute has lead to a series of lawsuits that are generically referred to as the "names litigations." They have been brought against underwriting managers, member's agents, and others in the Lloyd's community. Most of these suits are going on in the U.K., and you have probably seen in the press that some of them have been successful. The courts have come back and said there is negligence here, and there is liability on behalf of the underwriting manager to the names that he was supposed to be representing.

Separate and distinct but running parallel to the U.K. names litigations were a series of litigations brought here in the U.S. Approximately 3,400 of the names at Lloyd's are Americans. Some, but not all of them, find themselves in a position where they've had very negative experiences, and they also are seeking to bring suit against various people at Lloyd's charging negligence and other issues. Being Americans and feeling that they would probably get a better deal in American courts, they have attempted to bring those litigations to the U.S. They have been, with one exception, uniformly rebuffed by the courts. Why? Lloyd's draws its members from all over the world; most of them are still British, but many are Americans, South Africans, Europeans, Australians and from elsewhere around the globe.

Lloyd's litigation surfacing anywhere in the globe is essentially viewed to be an unworkable way for Lloyd's to effectively resolve disputes with its members. Therefore, one of the conditions that names are required to meet when they join the market is they must agree that if this kind of dispute does arise, it will be resolved in the U.K. American courts have ruled, with the sole exception of the Texas District Court, that agreement by the names is binding, and if there is a dispute with somebody in the Lloyd's community, take it to the U.K. as agreed. As we're seeing, the U.K. courts are willing to give redress in appropriate places, so it is a fair forum for your claim to be heard. Policyholders have been paid and continue to be paid 100 cents on the dollar. This is not really a dispute involving policyholders; it's a dispute as to who's responsible for paying policyholders, the names or others within the Lloyd's community.

The names' litigations are destructive in my opinion. In a number of respects they have to pay lawyers, such as myself, both to attack and defend, and that drives up the cost of doing business. You've heard the discussion earlier about the LMX spiral at Lloyd's. The fact of the matter is that much of the insurance and reinsurance that's done at Lloyd's is done where you have one group of underwriters reinsuring another. One of the interesting ramifications of that is that I could be an unhappy name that is suing for negligence underwriters on syndicate number one that I participated on and I win. The court comes back and says, yes, they were negligent, here's your award. The underwriting managers for syndicate number one then go to their errors and omissions coverage to get the money to pay, which is provided by syndicate number two, where I am also a member. Basically I'm taking money out of my right pocket to put it in my left pocket. Also, it's causing a concern with respect to Lloyd's. It's causing policyholders to become somewhat uncomfortable. For all these factors it's felt that everything that has happened in the Lloyd's community in 1992 and prior years has to be resolved. What is the solution? We believe the solution is Equitas.

What is Equitas? Equitas, in the final analysis, is going to be a U.K. reinsurance company. It will be regulated like any other reinsurer by the U.K. Department of Trade and Industry, which is the domestic regulator in the U.K. The idea is that good and bad business, regardless of quality, written at Lloyd's in 1992 and prior will have to be reinsured to close and to Equitas. You don't have a choice. If you're sitting on a very profitable long-tail book of business from 1992 and prior, and you would like to keep that, it will go into Equitas along with the bad business.

Why is it that Equitas is going to be able to effectively calculate reinsurance to close, and to efficiently run off that business even though individual syndicates have not been able to? Syndicates typically are one-year ventures. They are, in the eyes of the law, formed and dissolved annually and then re-formed for the succeeding year. Because of the short-term nature of the syndicate, their investment strategies tend to be short term. However, what you're finding is that the syndicates are taking on long-term liabilities and trying to match them up against short-term assets. That is proven to be a very inefficient way to go about things. Equitas won't have that encumbrance. Equitas will be a stand-alone reinsurance company, and it will be able to more effectively match its investments to its projected payout of liabilities. This means that long-tail, higher-yield investments will be more readily available to Equitas to match the long-term liabilities as they're paid off.

Also, by centralizing claims management, centralizing the collection of reinsurance, all of which will be assigned to Equitas, you're bringing the economies of scale into play. This is instead of the massive duplication that takes place as syndicate one, syndicate two, syndicate five, and syndicate 200 try to resolve business by going through that incredible duplication of effort. All of this will be centralized in a single reinsurance facility called Equitas, and it will substantially improve the efficiency of the system.

What's the current deal with respect to Equitas? The Department of Trade and Industry (DTI), as I said, is going to be the domestic regulator for Equitas. It has given conditional approval to Equitas to get up and running. They've approved the basic business plan. What is the condition? The DTI, being the regulators that they are, would like Equitas to actually have the money necessary to pay the claims. We are going through the final stages of reserve calculation. There is a major actuarial firm here in the U.S. that's taking the lead on that. Virtually every actuary in London is also involved in calculating the reinsurance-to-close premium for all the underwriters and all the syndicates sent to Lloyd's. It is a massive actuarial exercise, as I'm sure you can appreciate. And there have been a couple of developments recently with respect to Equitas that have been quite positive and that have substantially increased the probability that the names will agree to it.

Some time ago Lloyd's released a preliminary estimate of what it's going to cost to get this thing running. What is going to be the total reinsurance-to-close premium that all of the names, 1992 and prior, are going to have to pay into Equitas to get it to run off. That estimate was in the range of £1.9 billion sterling. Recently that number was significantly revised downward to make it a substantially more attractive offer to the names. The current number is in the range of about £1 billion sterling. Why? That was the first question I asked when I was told that was the decision.

The explanation that has been given to me by the actuaries who are putting it together is that the original £1.9 billion estimate was based upon the initial reserves of all the business, including short-term liabilities, that were written in 1988–92. They now have more experience with the actual payouts for that short-term business. Here we're talking about lines like marine, aviation, and transport cover. They compare the actual payout stream to the initial reserve estimates, and they find that Lloyd's was very severely overreserved for those lines of business when they issued their original estimate. The actual payout streams have been much lower than the reserves would have predicted. For that reason, they feel justified in revising the reinsurance-to-close premium downward, and that's where the £1 billion figure comes from today.

Equitas is part of reconstruction and renewal, meaning settlement. I think Lloyd's leadership realizes that the names litigation, as I said, is destructive of the interest of the market as a whole, ultimately destructive of the names interests, and also ultimately damaging to the interest of the policyholders. For that reason, those names that wish to join Equitas get what's called "finality," which means all open years 1992 and prior will be closed into Equitas. Those who want to withdraw from the market at that point will be allowed to do so. They will also have a reasonable certainty as the total amount that they're going to have to pay to fulfill their obligations to Lloyd's. As part of the trade-off for getting finality and for being allowed to close all open years, you'll be called upon to settle all of your claims with respect to the Lloyd's community, so that the names litigation will come to an end.

As part of that overall effort, Lloyd's has given a settlement offer to the names. Part of the offer is called a debt credit, which basically means Lloyd's will help you pay some of your reinsurance-to-close premium in Equitas in the final analysis. That's what that credit is—a promise to help pay the premium. The other part of the offer is a cash settlement to help those who have already paid out great amounts of money to recover some of their losses. The total settlement package was originally projected to be £2.8 billion sterling. That was recently revised upward to £3.1 billion sterling. Why? The reason is an additional £300 million was kicked in by the Lloyd's brokers (who make their living placing business at Lloyd's and have a very significant interest in the continuance of the Lloyd's market) and by syndicate auditors who, like everybody else in the Lloyd's community, have gotten caught up in these litigations and have the same interest as everybody else in seeing it end.

What is the Equitas timetable, as of today? Those of you who are following the situation closely know that this schedule has been revised several times. The main reason it has been revised, frankly, is because the actuarial exercise in trying to determine the reinsurance-to-close premium number for so many diverse lines of business, written by so many different syndicates over such a long period of time, has been an incredibly complex exercise. It has taken longer than people originally anticipated. The finality statements, as they're being called, which are actually the settlement offer, will be published for the various names at some point in July [1996]. This will be a piece of paper saying, this is what it's going to cost you to get out or to resolve everything. This is what your total reinsurance-to-close premium is in Equitas. This is how much we will offer you as an individual in debt credits to help you pay that premium. If you're entitled to a cash settlement under this overall package, this is how much we're going to give you, if you agree to it.

The names will then be called upon to decide yes or no, I'll do it or I won't. They'll have to communicate that decision to Lloyd's. Then in August [1996], the Lloyd's leadership will get together based upon the responses received from all of the names and decide yes, we have enough of an interest expressed by all the names to say we will go ahead with Equitas, or no, we don't have enough of a positive response, Equitas is a nonstarter.

One of the questions I have been asked over and over again is whether 100% participation by all of the names in Equitas is essential. The answer to that question is no. The actuaries have worked in the probability that because of the emotional nature of some these disputes, some people, no matter how good the settlement offer, are going to say, "I'm fighting to the death." Others frankly are bankrupt and they have nothing to lose, and they're not going to say yes to anything. It's anticipated that there will be a group of names that will say no. The question is whether or not enough of the market is going to say "Yes, I will do it; I will build critical mass to get enough funds into Equitas," so that Equitas can get up and running. I said the actuarial projections have assumed that there will be a shortfall. How much? I've heard 70% and 80% kicked around. The question is going to be how much we're going to have in Equitas. Will it be enough to enable it to get up and running?

The prognosis for Equitas is the big question. There have been a number of meetings by Lloyd's leadership with members around the U.S. and around the world to talk about Equitas. The reports I'm getting back from the folks at Lloyd's is that one of the most powerful motivational forces known to man is taking over, which is enlightened self-interest. It appears that a large number of the names are concluding that Equitas is not a perfect solution, but it is the best of all available solutions and that it should go ahead. Right now, the message I'm hearing from Lloyd's is very positive. Obviously no one can guarantee what will happen, but I think the news is quite good.

Let's turn to the item that has received most of the recent attention in the American press and that, at one point, was a very real threat to Lloyd's, but I believe not much of a threat now. I'm speaking of the securities litigations. As I said earlier, a number of the U.S. names wanted to bring suit in the U.S., feeling they would get a better deal in American courts than they would in the U.K. courts. Those efforts have largely failed. A name then went to state securities regulators to say, "I'm not really an insurer; I'm an investor. I'm not really joining on as an underwriter, I'm analogous to somebody who is buying a security. They did not comply with the state security laws when I joined Lloyd's, and therefore, you should bring a states securities action against them." That basically is the issue. What is membership at Lloyd's? Is it becoming an insurer or is it becoming an investor or buyer of securities? The bottom line is truly the issue.

A number of state regulators thought that there was enough of an issue there that they were going to initiate litigations brought by their state corporation commissions. California was the first. There are about eight that have done it. State security regulators all around the country are at least interested in the issue, so they're all watching it.

Why was this such a significant issue? Not so much because this dispute arose, but because of what the security commissioners saw as interim relief. What they said was that we want to put an attachment on the reserves that Lloyd's holds in the U.S. in Citibank in New York, called the Lloyd's American Trust Funds, to pay its U.S. policyholders. We want to attach that and freeze it, so that in the event that the names win, later on there will be money to pay them. What they didn't really factor in is the fact that what they're talking about is that the reserves that will be used for policyholders would therefore be frozen, and not available to pay losses as they come due. That obviously would have been a very severe threat to Lloyd's. U.S. regulators obviously would have been under very severe pressure to take some action if the payment stream to the policyholder stopped. For that reason, you came into a strange situation where you had different state regulatory agencies from within the same jurisdiction suing each other. That's basically what happened in California.

The question now is, why did insurance regulators at the NAIC level and in individual states led by California, New York, Texas, Louisiana, and many other jurisdictions become involved in this? They became involved not because they wanted to get involved in the underlying question, which is, what is the fair resolution between the unhappy names at Lloyd's? They became involved because they agreed with Lloyd's that first and foremost, the policyholder has got to get his money. Just as if Lloyd's were an insurance corporation, I, as a regulator, would object to somebody trying to attach their loss reserves for the benefit of purchasers of stock, for the same reason I'm going to object to efforts to attach the Lloyd's American Trust Fund.

What would have happened if the Lloyd's American Trust Fund was frozen, which thankfully did not happen. Chuck Quackenbush, Commissioner in California, calculated that 15 of his domestic companies would become instantly technically insolvent overnight. A large number of additional insurers would have impaired surplus because of the reinsurance that they're relying upon at Lloyd's. That's just what would happen to the California domestics. You extrapolate that to what would have happened to everybody licensed in California, and you begin to understand exactly what kind of ramifications you're having.

In addition, it became apparent that a number of hospitals would have to close their doors for lack of liability cover. The list is virtually endless as to the negative ramifications had Lloyd's stopped trading because of the freezing of the LTS. My point of view is that the securities commissioners did not fully understand the ramifications of the actions that they were taking when they took them initially. They didn't understand how many U.S. insurance companies rely upon Lloyd's for their reinsurance and how many American insureds rely upon Lloyd's for their coverage. What happens if that suddenly goes away? They have now, I think, gotten a much better understanding of what that issue is all about. They've now reached stand-still agreements with Lloyd's, basically a ceasefire. I think what's happening at the end of the day is that everyone is sitting down to see what happens with respect to Equitas. If Equitas and reconstruction and renewal in the settlement package are successful as we hope they will be in resolving all these issues, then perhaps the securities litigation will go away.

Mr. Perry L. Wiseblatt: What if Equitas doesn't come off? What is the future?

Mr. Mulhern: The last time I gave this speech, I said that the phrase "may you live in interesting times" is frequently offered as a curse. I said that the last several years have been very interesting times for Lloyd's. What happens if Equitas does not get off the ground? Times will get significantly more interesting. Lawyers will probably do very well financially. I shudder to think what might happen to the aftershocks that will run through the world's insurance community; it's a very serious issue. Bottom line, what happens? I don't know for sure. In 1992 and prior years there was a significant issue that had to be resolved, one way or another. If Equitas is not successful, or if the settlement is not achieved, we're going into some very serious times, in my opinion.

Mr. James W. Pilgrim: I have a question for Jim Wertheimer. Can you give us a quick synopsis of why UNUM decided to participate?

Mr. Wertheimer: I think it's bottom-line economics. The personal accident market is probably one of the more attractive markets at Lloyd's. It's a short-tail liability market. It doesn't have many of the unknowns that the other markets have suffered. This is actually being done through our Duncanson & Holt affiliate, and it is very well experienced in personal accident, both in the U.S. and in the U.K. We know the underwriters who are the main syndicate underwriters for that line, and we felt that to have direct participation as opposed to indirect would be a very good way to do business. We could expand our capacity and have just a more dominant share of that market. I think we will not be limited solely to that power of attorney market, but that will be our dominant area of participation, and we expect to earn the same kind of returns we have historically earned.