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REGULATORY CRISIS AT LLOYD'S OF LONDON: REFORM FROM WITHIN

Ian Kelley*

INTRODUCTION

Lloyd's of London¹ ("Lloyd's" or "the Society") is the most well-known insurance market in the world.² For three hundred years, Lloyd's maintained a reputation as perhaps the safest place in the world to insure risk.³ From a modest start in a London coffee house, where men gathered to protect against the risks of ocean trade by buying and selling marine insurance policies,⁴ Lloyd's has grown into a worldwide market for highly sophisticated insurance and reinsurance transactions.⁵

Recently, Lloyd's has been in a state of crisis.⁶ Due to a string of catastrophes in the late 1980's, Lloyd's suffered enor-

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1. See ADAM RAPHAEL, *ULTIMATE RISK* 18-26 (1994) (discussing Lloyd's origins). Lloyd's of London is an insurance market. *Id.* at 18. It began in a seventeenth-century London coffee house owned by Mr. Edward Lloyd. *Id.* at 19-20. Merchants met for coffee and to swap rumors regarding the maritime trade. *Id.* at 21. This "intelligence" became the basis for the marine insurance policies that were the first policies bought and sold at Lloyd's. *Id.* at 21-22. From these modest origins, Lloyd's grew into one of the largest insurance markets in the world. *Id.* at 22. Today, as a full-service, worldwide market for insurance, Lloyd's retains many traditions. *Id.* at 17-18. There are still "waiters" in eighteenth-century uniforms who work in the "Room," where the underwriting business is done. *Id.* at 17. There is the Lutine Bell, taken from a French frigate surrendered to the British by royalists during the French Revolution and later sunk. *Id.* at 18. It hangs in the center of the Room and is traditionally rung to alert the market of news of an overdue ship, once for bad news, twice for good. *Id.* Lloyd's has been publishing shipping intelligence since Edward Lloyd first published his newsheet, *Lloyd's News*, in 1696. *Id.* at 21. Lloyd's has a proud history of never failing to pay a valid claim, and a tradition based on three centuries of honor and fair dealing. *Id.* at 18. The Lloyd's market is proud of its reputation and history. *Id.* Faced with difficulties in recent years it is struggling to restore its good name. *Id.* at 41.

2. *Id.* at 1.

3. *Id.*

4. LLOYD'S OF LONDON, *LLOYD'S: A PORTRAIT* 16 (on file with Author).

5. *Id.* at 2-3.

6. Richard W. Stephenson, *Lloyd's Tries to Insure Its Future*, N.Y. TIMES, Apr. 30, 1993, at D1. In April 1993, Lloyd's announced the worst losses in its over 300-year history, over US\$4 billion in 1993 and an expected US\$1.5 billion for 1994. *Id.*; see

mous losses.⁷ The unlimited liability of Names⁸ ("Names"), the individuals who provide the market's capital, has been a contributing factor in the market's difficulties.⁹ Names faced large cash calls as the number of catastrophe claims rose.¹⁰ Some Names have been driven to bankruptcy and even suicide as a result.¹¹ Many Names blame a lack of regulatory oversight in the market for their difficulties.¹²

In April 1993, Lloyd's leadership responded to the crisis with a Business Plan¹³ ("the Business Plan") that, among other things, created a new, stricter role for the Regulatory Board, one that would emulate outside regulation.¹⁴ The Business Plan explained that the Regulatory Board, along with a Market Board, was part of a new governing structure set up at Lloyd's in January, 1992.¹⁵ Because Lloyd's is a self-regulated market, the Regulatory Board is internal, though this may soon change.¹⁶

This Note examines the question of whether Lloyd's should be allowed to continue to regulate itself, or whether the Lloyd's Act of 1982,¹⁷ which guarantees Lloyd's right to self-regulation,¹⁸ should be overturned. Part I discusses how Lloyd's market structure and self-regulatory structure contributed to the present crisis. Part I also details Lloyd's history and explains its trading system. Part II describes changes to the Lloyd's regulatory system that were initiated by the Business Plan. Part II also addresses criticisms of Lloyd's system of self-regulation and possible alter-

LLOYD'S OF LONDON, PLANNING FOR PROFIT: A BUSINESS PLAN FOR LLOYD'S OF LONDON 2 (1993) [hereinafter BUSINESS PLAN] (acknowledging severity of losses).

7. See Julian Barnes, *The Deficit Millionaires*, NEW YORKER, Sept. 20, 1993, at 77-78 (detailing catastrophes).

8. See LLOYD'S: A PORTRAIT, *supra* note 4, at 24 (explaining system of unlimited liability).

9. See Barnes, *supra* note 7, at 74 (explaining effects of losses on Names).

10. See RAPHAEL, *supra* note 1, at 178 (explaining effect of catastrophe losses on Names).

11. RAPHAEL, *supra* note 1, at 7-8.

12. Joanne Hart, *Lloyd's Facing Double Scrutiny*, EVENING STANDARD, Jan. 30, 1995, at 31 (discussing fact that Names who face billions of pounds of losses, blame lack of external regulation).

13. See generally BUSINESS PLAN, *supra* note 6 (detailing plan for Lloyd's future).

14. See *id.* at 15 (detailing new management approach).

15. *Id.*

16. See *id.* at 30 (stating that fully independent regulation is not possible under present statutory scheme).

17. Lloyd's Act, 1982, ch. 14 (Eng.).

18. *Id.* pmb. (Eng.).

natives to the present system. Part III argues that a continued system of self-regulation will be effective, if modified in the correct ways, and suggests appropriate changes. This Note concludes that the regulatory system presently in place at Lloyd's is sufficient to properly regulate the market, and that reformers' time and effort should be spent making substantive regulatory changes within that system, rather than debating legislative reform.

I. LLOYD'S STRUCTURE AND THE CRISIS

The crisis at Lloyd's was precipitated not only by catastrophe claims,¹⁹ but also by structural weaknesses that existed in the market.²⁰ The Lloyd's market structure grew out of its unique historical beginnings²¹ and is subject to certain stresses that do not affect other insurance markets.²² Lloyd's, like many financial institutions in the City of London (the "City"), has traditionally been a self-regulated market.²³ This right to self-regulate was codified in the Lloyd's Act of 1982.²⁴ The present crisis has revealed the extent of systemic problems in the Lloyd's market, many of which stem from the fact that self-regulation, in practice, has meant little or no regulation at all.²⁵

A. Basic Structure of the Lloyd's Market

Lloyd's of London is an insurance market, not an insurance company.²⁶ Lloyd's is a unique market and a historical anom-

19. Barnes, *supra* note 7, at 78 (detailing catastrophes).

20. JONATHAN MANTLE, *FOR WHOM THE BELL TOLLS* 4 (1992). "Massive losses caused by a series of natural catastrophes compounded by lack of regulation and doubtful market practices had brought Lloyd's to its knees." *Id.* "The 1989 and 1990 losses are the result of catastrophes such as Hurricane Hugo, the San Francisco earthquake, the Exxon Valdez spill and the Piper Alpha Oil Rig disaster and the spiral effect of excess of loss reinsurance which have had a dramatic effect on the bottom line." Daniel M. Bianca, *Understanding Lloyd's*, 679 *PLI/COMM* 31 (1993).

21. See RAPHAEL, *supra* note 1 (reciting Lloyd's history).

22. MANTLE, *supra* note 20, at xi-xii.

23. See *In the Beginning Was the Word*, *OBSERVER*, Jan. 16, 1994, at 5 [hereinafter *In the Beginning*] (reciting history of self-regulation in City).

24. Lloyd's Act, 1982, *pmbi.* (Eng.).

25. See Clare Sambrook, *Names Are 'Insider Dealing Victims'*, *DAILY TELEGRAPH*, Jan. 31, 1995, at 25 [hereinafter *Insider Dealing Victims*] (quoting Lloyd's critic on lack of regulation).

26. See RAPHAEL, *supra* note 1, at 2-3 (describing Lloyd's as market, and comparing its present situation to that of insurance companies). "There are four principal markets

aly.²⁷ For example, the capital that guarantees the risk underwritten by each Lloyd's underwriting syndicate has traditionally been provided by Names.²⁸ Names pledge their personal wealth in order to be permitted to underwrite risks.²⁹ Their business is conducted by the underwriting professionals in the market of Lloyd's.³⁰ Names are actually individual traders, not passive investors, and are subject to unlimited liability.³¹ They have relinquished control over the decision-making with respect to their underwriting activities.³²

1. The Business of Lloyd's

Lloyd's has been operating since its inception according to

at Lloyd's: marine, non-marine, aviation and motor." *Understanding Lloyd's, supra* note 20, at 2.

27. MANTLE, *supra* note 20, at xi-xii. "Lloyd's is an insurance institution unlike any other." *Id.*; RAPHAEL, *supra* note 1, at 17. "Step inside, and you will see frock-coated waiters resplendent in blue uniforms straight out of the eighteenth-century coffee house, contrasting with soberly suited brokers swarming up and down the escalators." *Id.*

28. RAPHAEL, *supra* note 1, at 48.

There are two kinds of Name: working Names, the professionals who work in the market as underwriters, brokers and agents . . . and — the majority — external Names who are, in effect, passive investors. Most are British, but no fewer than eighty-five countries are represented at Lloyd's. . . . [T]hose who put their capital at risk in the market may regard themselves as investors, but technically they are sole traders. Each Name trades on his own account, with *unlimited personal liability*.

Id. (emphasis added).

A Lloyd's Name bestows complete authority for his insurance business on the active underwriter writing business for the syndicate on which the Name participates. The Name effectively places his or her personal wealth in the hands of someone who will usually be a complete stranger. The passive underwriter is known as an "outside" or "external" Name, to distinguish him or her from underwriters actively working in the market, or "working" Names. Nevertheless, the Names, either inside or outside Lloyd's, are collectively "Underwriters at Lloyd's" and it is from them . . . that Lloyd's derives its capacity to write insurance.

Understanding Lloyd's, supra note 20, at 2.

29. RAPHAEL, *supra* note 1, at 49. "To become a Name, the investor does not have to hand over capital, he merely has to show that he possesses it." *Id.*

30. *See id.* at 49 (stating members' agent has complete charge of Names' underwriting).

31. *See id.* at 48 (explaining Name is liable "down to his last shirt button").

32. *Id.* at 49. "Names are placed on [underwriting] syndicates by members' agents, who are responsible for supervising the Names' affairs, and who act as the link between the Name and the underwriter." *Id.* It is, or has been, a relationship of total trust. *Id.* Such a unique relationship demands "utmost good faith," and indeed, *Uberrima Fides*, or Utmost Good Faith, has long been Lloyd's trading standard. *Id.* at 1.

the basic principle of insurance: the diffusion of risk.³³ If one wished to protect oneself from the risk of the loss of, for example, a ship returning from China laden with silk and spices, one found a group of underwriters each of whom was willing, for the price of a premium, to insure a percentage of the risk.³⁴ The idea was that by spreading the risk, one might provide that no single underwriter's liability for claims would be so great that he would be unable to meet his obligations.³⁵ As Lloyd's grew in size and sophistication, market professionals began to specialize.³⁶ Despite the development of the current system of independent Lloyd's brokers, who act as the sales force,³⁷ and underwriting syndicates,³⁸ which are professionally managed, the basic principle remains the same.³⁹

Today, if one wishes to insure a ship, one speaks with an insurance broker, who speaks directly with a licensed Lloyd's broker⁴⁰ who specializes in such matters.⁴¹ The broker, in turn, speaks with professional underwriters, also specialists, to negotiate a price for which each of the underwriters will accept a portion of the risk.⁴² The conversation between Lloyd's broker and active underwriter⁴³ takes place in the underwriting area at

33. See RAPHAEL, *supra* note 1, at 176 (stating that concentration of risk violates basic principle of insurance: diffusing risk).

34. See LLOYD'S: A PORTRAIT, *supra* note 4, at 16 (describing means of insuring ships and cargoes in 17th century).

35. See LLOYD'S OF LONDON: INFORMATION PACK, LLOYD'S TODAY 9 (1994) (on file with Author) [hereinafter INFORMATION PACK] (stating market is based on risk-spreading).

36. See LLOYD'S: A PORTRAIT, *supra* note 4, at 24 (explaining coffee house merchant of past gave way to professionals).

37. *Id.* at 2. The system of syndicates and brokers is as follows: syndicates are comprised of individual underwriters and managed by professionals. *Id.* Independent brokers, registered at Lloyd's, act as a commissioned sales force. *Id.*

38. *Id.*

39. See INFORMATION PACK, *supra* note 35, at 9 (stating market is based on risk-spreading).

40. See LLOYD'S: A PORTRAIT, *supra* note 4, at 2 (noting Lloyd's accredited brokers' intimate knowledge of market).

41. *Id.*

42. See *id.* at 2 (explaining business brought to specialist underwriters by Lloyd's brokers). "The syndicates in each [of the four markets] is headed by prominent active underwriters from that market and each has within it recognized expert underwriters in subcategories of risks in that market such as satellites, professional liability, livestock mortality, fine arts and so on." *Understanding Lloyd's*, *supra* note 20, at 2.

43. See MANTLE, *supra* note 20, at xi (stating broker takes risk onto floor of Room seeking underwriters to provide cover).

Lloyd's known as "the Room."⁴⁴ Many layers of brokers and reinsurance underwriters usually exist between the insured and those who pay the final cost of a claim.⁴⁵

The underwriters at Lloyd's are grouped into syndicates.⁴⁶ Each syndicate is divided into active underwriters and Names.⁴⁷ The active underwriters do business in the Room where they accept risks.⁴⁸ The Names are capital providers, individuals who accept unlimited liability in exchange for the chance to earn large underwriting profits.⁴⁹ It is their money that underwrites the risk.⁵⁰ Some Names are also working members, but the majority are external Names who do not work in the market.⁵¹

Syndicates are managed by managing agents⁵² that employ the professional underwriters who accept risk on behalf of the Names.⁵³ Another kind of agent, known as a members' agent,⁵⁴

44. *Id.*

45. RAPHAEL, *supra* note 1, at 175. "By layering risks vertically according to value as well as spreading them horizontally among dozens of reinsurers, no single underwriter need expose himself or the Names he represents to intolerable losses in the event of a series of catastrophes." *Id.*

46. Eileen M. Dacey, *Litigation Issues Unique to Lloyd's 2* (Feb.-Mar. 1995) (paper delivered at Practising Law Institute 12th Annual Insurance, Excess and Reinsurance Coverage Dispute Program).

47. See RAPHAEL, *supra* note 1, at 46 (describing management of syndicates).

48. See MANTLE, *supra* note 20, at xi (stating that active underwriters write policies on floor of Room).

49. See RAPHAEL, *supra* note 1, at 48 (explaining role of Names).

50. *Id.*

51. *Id.*

52. See *id.* at 45 (explaining role of managing agent).

53. *Id.*

54. See *id.* at 49 (explaining role of members' agent).

Concerns have been voiced about possible conflicts of interests in situations where managing agencies own members' agencies. An advantage to such an arrangement is that the members' agent will be closer to the business being written in the Room and have more direct contact with the active underwriters on that agency's syndicates, thus giving the agent broad information with which to protect his client. However, the managing agent may have a perceived obligation to keep the syndicates running. Ian Hay Davidson, Lloyd's first Chief Executive, has drily noted:

The Name who goes direct to a managing agent will be sure of getting on to the syndicates managed by that agent, but is likely to be the last to hear when it is time to come off those syndicates. He will have the advantage that the desire of other agents for places [for their Names] on his own agent's syndicates will give him reciprocal access to a wider range of syndicates. There is no simple answer: some Names prefer to talk to the organ grinder; others prefer to deal through the monkey.

Understanding Lloyd's, *supra* note 20, at 4.

manages the placing of Names on various syndicates.⁵⁵ The business affairs of the Names have traditionally been managed completely by market professionals, whose accountability to the Names themselves was slight.⁵⁶ The entire system operated in a secretive way,⁵⁷ relying to an enormous extent on trust,⁵⁸ and remained unchallenged until the recent crisis.⁵⁹

2. The Role of the Names

Whereas, traditionally, the ranks of the Names were filled mainly by the British upper-class,⁶⁰ financial requirements for membership were relaxed in the 1970's and 1980's.⁶¹ The capacity of the market increased immensely at that time, when the number of Names increased from about 12,000 to over 30,000.⁶² Being invited to join Lloyd's, with its history, patrician atmosphere, and aura of exclusivity, was considered an honor similar to being asked to join one of England's most exclusive clubs.⁶³ Another attractive feature of Lloyd's was its reputation as an impeccable blue-chip investment.⁶⁴

The Lloyd's system of trading involves the potential for high profits.⁶⁵ Although traditionally, only the wealthy were members of Lloyd's,⁶⁶ the upper middle-classes also became attracted to Lloyd's,⁶⁷ particularly under the Labour government of the 1970's, when the tax benefits were substantial.⁶⁸ Many North

55. RAPHAEL, *supra* note 1, at 49.

56. *See id.* (describing lack of information available to Names).

57. *See id.* at 43 (describing culture of secrecy).

58. *See id.* at 49 (describing relationship of total trust between Names and those who underwrite on their behalf).

59. *See id.* at 2 (describing disappearance of 'utmost good faith' as losses mounted).

60. *See Barnes, supra* note 7, at 78 (describing new breed and rising number of Names).

61. *Id.*

62. *Id.*

63. *Id.*

64. *See MANTLE, supra* note 20, at 4 (describing Lloyd's as blue-chip institution).

65. *See RAPHAEL, supra* note 1, at 51 (describing advantages of Lloyd's system of trading).

66. *See Barnes, supra* note 7, at 78 (describing new breed and rising number of Names).

67. *Id.*

68. RAPHAEL, *supra* note 1, at 51.

American Names also joined during this period,⁶⁹ along with many others from outside England.⁷⁰ The membership expansion included some who were not well-prepared for the financial burdens when the losses accumulated and the cash calls began.⁷¹

To join Lloyd's, a prospective Name must demonstrate a certain amount of personal wealth, an amount at its lowest level of UK£37,500 for a class of "mini-Names."⁷² While Lloyd's would not include the value of one's home as part of net worth, it began, during the period of expansion in the 1970's and 1980's, to accept a bank guarantee on one's home.⁷³ Many people were thus able to join Lloyd's in a manner that contravened the spirit of rules that Lloyd's had in place to protect Names against the possible loss of their homes.⁷⁴

Once membership is offered, a "Rota meeting"⁷⁵ is held to explain the risks of unlimited liability.⁷⁶ Each Name is personally liable to the extent of his or her personal wealth for all

69. See MANTLE, *supra* note 20, at 33 (marking January 1, 1969, as date first U.S. Names joined).

70. RAPHAEL, *supra* note 1, at 48. "Most [Names] are British, but no fewer than eighty-five countries are represented at Lloyd's. There are sizeable numbers of Names in the United States, Australia, Ireland, Canada, South Africa, and New Zealand. There are even Names in such unlikely capitalist havens as North Yemen, China, and Tonga." *Id.*

The cynical might suggest that we have seen the result of past Lloyd's membership drives in the current crops of American, Canadian and Antipodean members. It seems unfair to raise such a sensitive subject when Lloyd's is earnestly trying to present an up-beat message, but the problem with admitting any member (individual or corporate) whose assets and wealth are largely based outside the jurisdiction of the English courts, does raise the spectre of whether it will be possible to recover those assets and wealth in the event of it ever becoming necessary to bankrupt that Name.

Deborah A. Tompkinson, *Challenge at Lloyd's*, 706 PLI/COMM 123 (1994).

71. See MANTLE, *supra* note 20, at 6 (describing effects of late 1980's catastrophes on new Names).

72. See *id.* at 33 (describing entrance requirements for "mini-Names" admitted during expansion).

73. See *id.* at 5 (stating a bank guarantee sufficient to cover deposit)

74. Barnes, *supra* note 7, at 80. "The financial conditions for joining were now less stringent and the rules more laxly monitored. (In theory, you were not allowed to put up your principal residence as part of the wealth you showed, but Lloyd's happily accepted a bank guarantee instead, and since the bank guarantee was based upon a charge on your house the effect was the same.) New money rushed to join Lloyd's." *Id.*

75. See *id.* at 83 (describing Rota Committee meeting where effects of unlimited liability are explained to Names by Lloyd's members).

76. *Id.*

claims.⁷⁷ Even death is no escape, as the liability passes to the estate.⁷⁸ Furthermore, even if Lloyd's collapsed and became insolvent due to its current difficulties, each Name would remain individually liable in full.⁷⁹

After the Rota Meeting, a Name settles on several "lines"⁸⁰ that he or she wishes to underwrite, such as thirty lines of UK£10,000 each.⁸¹ A Name must then put up only one-third of the total UK£300,000, to be deposited in the Premium Trust Funds,⁸² which are similar to an insurance company's reserves.⁸³ From this point on, a Name can earn profits not just on the amount he places on deposit, but on the total he pledges, because each Name is personally underwriting risks up to the full UK£300,000.⁸⁴ Furthermore, the UK£200,000 not on deposit can be invested elsewhere, while simultaneously earning profits at Lloyd's.⁸⁵ The tax benefit comes from offsetting underwriting losses against taxable income.⁸⁶ Under the Labour government of the 1970's, when the top tax rate reached a high of ninety-eight percent, Lloyd's became an attractive investment.⁸⁷

3. The Tradition of Self-Regulation in the City

Lloyd's operates under a system of self-regulation.⁸⁸ This system has historical roots,⁸⁹ and was codified in the 1982 Lloyd's

77. *Id.*

78. See RAPHAEL, *supra* note 1, at 52 (explaining that death is no escape from Names' extant liabilities).

79. See BUSINESS PLAN, *supra* note 6, at 2 (explaining effect on Names if Lloyd's should fail).

80. MANTLE, *supra* note 20, at xii. "The members or 'Names' at Lloyd's commit themselves to underwriting a certain sum of business each year: say £500,000. This £500,000 is divided into smaller sums or 'lines' of £10,000 or £20,000 on a spread of thirty or forty syndicates." *Id.*

81. *Id.* at xii.

82. INFORMATION PACK, *supra* note 35, at Fact Sheet 1.

83. See *id.* (describing Lloyd's security).

84. MANTLE, *supra* note 20, at xii. "The members share syndicates' profits according to the size of their 'lines' and the success of the active underwriters." *Id.*

85. See *id.* at 5 (describing how Lloyd's allowed money to be earned on twice).

86. See RAPHAEL, *supra* note 1, at 51 (describing tax consequences of Lloyd's membership).

87. *Id.*

88. BUSINESS PLAN, *supra* note 6, at 30 (describing statutory position). "[A] number of . . . City institutions . . . still regulate themselves. By far the largest is . . . Lloyd's of London . . ." *In the Beginning*, *supra* note 23, at 5.

89. See *In the Beginning*, *supra* note 23, at 5 (discussing history of self-regulation in City).

Act, after much debate in Parliament.⁹⁰ Lloyd's is the foremost example of the system of self-regulation that has traditionally governed the financial institutions of the City.⁹¹ Lloyd's is one such institution that has successfully resisted regulatory changes in recent years.⁹² Self-regulation in the past meant that practitioners in London financial institutions policed themselves.⁹³ In other words, a gentleman's word was his bond, and those who broke the rules were shunned and could no longer participate in the City's business.⁹⁴ With the advent of technology and the globalization of the marketplace, and the resultant fraying of personal ties, fraud increased.⁹⁵

The beginning of the end of the old regime arrived in the 1980's with the massive deregulation known as the "Big Bang."⁹⁶ The "Big Bang" was a move away from restrictive practices that were making the London securities market uncompetitive in the world marketplace.⁹⁷ This deregulation of the City's financial services industry was followed by its re-regulation under the expansive Financial Services Act ("FSA") passed in 1986.⁹⁸ The FSA was passed because some practitioners were able to abuse

90. See John Moore, *Attempts to Change Lloyd's Bill 'A Wrecking Operation'*, FIN. TIMES, Feb. 1, 1982, at 3 [hereinafter *Wrecking Operation*] (describing Parliamentary maneuvers).

91. See *In the Beginning*, supra note 23, at 5 (discussing history of self-regulation in City).

92. See Patrick M. Creaven, *Inside Outside Leave Me Alone: Domestic and EC-Motivated Reform in the U.K. Securities Industry*, 60 FORDHAM L. REV. S285 (1992) (describing regulatory changes in City pursuant to Financial Services Act); see also *Insider Dealing Victims*, supra note 25, at 25 (stating Lloyd's exemption from Financial Services Act).

93. See *In the Beginning*, supra note 23, at 5 (describing self-regulatory practice).

94. See *id.* (stating that those who failed to honor their contracts were shunned and ostracized).

95. *Id.*

96. See Creaven, supra note 92, at S285 (describing deregulation and re-regulation of City financial institutions in 1980's).

97. See *id.* at S287-88 (describing market fears regarding uncompetitiveness).

98. Financial Services Act (1986) (Eng.).

The Financial Services Act is the most comprehensive overhaul of investor protection legislation for 40 years. . . . The objectives were stated to be Efficiency, Competitiveness, Confidence and Flexibility. . . . The Act modifies and extends its pre-existing investor protection laws and includes reforms relating to listing of securities, offers of unlisted securities, takeovers, insider dealing, collective investment schemes and reciprocity with other countries in respect of financial services.

J. Iain Murray, *Globalization of Government Securities Market: The 'Big Bang' and the United Kingdom Domestic Market, the Financial Services Act, and the New Regime for U.S. Government Securities*, 555 PLI/CORP 619 (1987).

the previous system of self-regulation that existed in the securities industry.⁹⁹ The FSA was a move away from self-regulation, although there was an effort to avoid an agency regime like that of the Securities and Exchange Commission¹⁰⁰ ("SEC") in the United States.¹⁰¹ Instead, the FSA retained elements of the system of self-regulation.¹⁰²

The FSA was intended by its framers to provide a statutory framework for the continued self-regulation of the investment industry that would allow more oversight, but also allow the market to remain competitive.¹⁰³ The FSA replaced all prior regulation of the investment industry, combining much of what had existed previously with new civil liability provisions.¹⁰⁴ The FSA also provided that five Self Regulatory Organisations¹⁰⁵ ("SROs") be set up to govern the affairs of the financial markets.¹⁰⁶ The Securities Association and the Association of Futures Brokers and Dealers merged in 1991 to form the Securities Association,¹⁰⁷ which now is the primary regulator of the London Stock Exchange and futures trade.¹⁰⁸ The three remaining Self Regulatory Organisations are independent and between them regulate the rest of the financial services market in the City.¹⁰⁹

99. See Creaven, *supra* note 92, at S286 (describing reasons for adopting FSA). "Although the FSA provided for continued self-regulation of the industry, it included provisions for stronger government guidance than in the pre-Big Bang era." *Id.* at S289.

100. Securities Act of 1934, 15 U.S.C. §§ 78a-78ff (1988 & Supp. V 1993)

The Commission . . . shall . . . have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of this title for which [it] is responsible or for the execution of the functions vested in [it] by this title, and may for such purposes classify persons, securities, transactions, statements, applications, reports, and other matters within their respective jurisdictions, and prescribe greater, lesser or different requirements for different classes thereof.

Id.

101. See Creaven, *supra* note 92, at S285 (describing efforts by drafters to avoid agency alternative). "FSA regulation . . . represents a middle ground between full agency regulation and earlier complete self-regulation." *Id.* at S289.

102. See *id.* (stating FSA provided for continued self-regulation).

103. See *id.* (stating FSA provided for self-regulation and kept U.K. competitive).

104. *Id.* at S285.

105. See *id.* at S292 (discussing SROs assumption of majority of self-regulation in U.K. investment industry).

106. See *In the Beginning*, *supra* note 23, at 5 (describing self-regulatory practice).

107. See *id.* at 5 (discussing SROs, including Securities Association, primary regulator of London Stock Exchange).

108. *Id.*

109. *Id.*

Lloyd's of London was exempted from the Financial Services Act.¹¹⁰ Lloyd's successfully argued that its business was insurance underwriting, and that Names were individual underwriters.¹¹¹ Lloyd's argued that Names were not investors¹¹² and that Lloyd's did not conduct "investment business," which was the main concern of the Financial Services Act.¹¹³ Lloyd's was allowed to retain its right to self-regulation that was codified in the 1982 Lloyd's Act.¹¹⁴

B. *The 1982 Lloyd's Act*

The Lloyd's Act of 1982 was the latest in a series of five Lloyd's Acts dating from 1871.¹¹⁵ The 1871 Act incorporated the Society under the name "Lloyd's of London," and formed a ruling Committee ("Committee") to attend to management and to exercise all the powers of the Society, subject to certain restrictions.¹¹⁶ Other powers were conferred by subsequent Lloyd's Acts in 1911, 1925, and 1951.¹¹⁷ The Lloyd's Act of 1982 was, among other things, an act to establish a Council of Lloyd's ("Council") and to define its functions.¹¹⁸ The Lloyd's Act of 1982 did change some of the functioning of the market but, more important for the purposes of the present discussion, it codified the practice of self-regulation.¹¹⁹ The debate at the time of its passage focused on what form Lloyd's regulation should take.¹²⁰

110. Jonathan Prynne & Sarah Bagnall, *Lords Fuel Lloyd's Debate*, TIMES, June 30, 1994, available in LEXIS, News Library, NON-US File.

111. *See id.* (stating Lloyd's argument that Names are underwriters, not investors).

112. *Id.*

113. Creaven, *supra* note 92, at S285 (describing FSA role in new regulatory regime for U.K. investment industry).

114. Lloyd's Act, 1982, pmbl. (Eng.).

115. *Id.*

116. Lloyd's Act, 1871, pmbl. (Eng.).

117. Lloyd's Act, 1982, pmbl. (Eng.).

118. *See id.* at I-25 (reciting purposes of Lloyd's Act).

119. *Id.*

120. *See* RAPHAEL, *supra* note 1, at 68-69 (describing reforms adopted by Parliament).

Key clauses of the Bill are facing an unprecedented degree of opposition in the House of Lords from sectional interests of the Lloyd's market.

A large part of the Lloyd's market has ranged itself against the Lloyd's establishment in an effort to prevent the legislation incorporating clauses vital to the effectiveness of the self-regulatory powers. . . .

A House of Commons committee insisted that Lloyd's included the divest-

1. Events Prior to the Passage of the Act

A series of scandals occurred at Lloyd's in the 1970's.¹²¹ These scandals precipitated passage of the Lloyd's Act of 1982.¹²² The last of these scandals involved a broker-controlled managing agency that exposed one of its syndicates to excessive financial risk by arranging reinsurance disproportionate to the syndicate's income.¹²³ Evidence of fraud and skimming profits was also found by the Lloyd's arbitration panel that investigated the incident.¹²⁴ The offending broker was expelled from the market through a cumbersome process promulgated by the 1871 Lloyd's Act.¹²⁵

Changes in the current self-regulatory system were necessary to prevent further scandals.¹²⁶ An inquiry was commissioned and headed by Sir Henry Fisher, a former High Court judge.¹²⁷ The resulting Fisher Report did not address the question of whether self-regulation was appropriate for the market.¹²⁸ Instead, changes were proposed that did not infringe upon the right of self-regulation.¹²⁹

ment clauses because it had identified conflicts of interest which could undermine Lloyd's self-regulatory powers which the market is seeking in its new regulation. . . .

The divestment clauses attempt to regularise the relationships between a broker, the broker's client, and the underwriting capital base of the market, to restore Lloyd's market character and identity, and to eliminate the possibility of abuse through conflicting interests within Lloyd's.

Those opposing the divestment clauses argue that the delicate fabric of the relationships within Lloyd's will be damaged. . . . Of more direct concern, brokers and underwriters, in defending the status quo within Lloyd's, have pointed out other conflicting interests within the market. These conflicting interests are serious and have far-reaching implications. Lloyd's and outside regulatory agencies will need to examine them closely.

John Moore, *Support Grows for Howden as Lloyd's Bill Enters Crucial Stage*, FIN. TIMES, May 24, 1982, at 21 [hereinafter *Support Grows*].

121. See generally, RAPHAEL, *supra* note 1, at 60-67 (discussing Savonita Affair, Sasse Affair, and Moran scandal).

122. See *id.* at 66-67 (discussing Christopher Moran). "[T]he Moran case proved that it was no longer practicable to run a modern international market with regulations fashioned in the nineteenth century." *Id.* at 67.

123. See *id.* at 66-67 (discussing Moran scandal).

124. *Id.*

125. *Id.*

126. *Id.*

127. See *id.* at 67-69 (describing Fisher's commission).

128. *Id.*

129. *Id.*

The principal change recommended by Fisher was that the Committee, formed under the 1871 Act, be replaced by a smaller council to oversee the regulatory process.¹³⁰ The new council would be composed of sixteen working members, eight external Names, and three members from outside the market.¹³¹ The council would have broad powers of inquiry and discipline over brokers, underwriters, and agents.¹³² The oversight of the daily affairs of the market would be administered by a smaller committee of the sixteen working members on the council.¹³³

A more controversial change, however, was one that had also been recommended in a similar, earlier inquiry by Lord Cromer.¹³⁴ Fisher proposed that brokers no longer be allowed to own managing agents because of inherent conflicts of interest in this arrangement.¹³⁵ Fisher did not address the ownership of members' agencies by managing agencies where the conflict of interest was perhaps greater because of the attraction for members' agents to place Names only on syndicates they themselves owned.¹³⁶ Nor did Fisher address the duty of Lloyd's agents to Names, or the need for more disclosure, or the practice of agents gaining substantial profit commissions even in years of overall underwriting losses.¹³⁷

2. The Debate over Passage of the Lloyd's Act of 1982

In 1982, during the passage of the latest Lloyd's Act, Fisher's proposals were debated at length in Parliament.¹³⁸ One issue affecting passage of the Lloyd's Act of 1982 was the relationship of certain Members of Parliament ("MPs") to the Lloyd's market.¹³⁹ Many of the Conservative Tories in the British Parliament are culturally, socially, and politically linked to

130. SELF-REGULATION AT LLOYD'S, REPORT OF THE FISHER WORKING PARTY 1-3 (May 1980).

131. *Id.*

132. *Id.*

133. *Id.*

134. See RAPHAEL, *supra* note 1, at 68 (comparing Fisher's terms of reference with earlier Cromer report).

135. *Id.*

136. *Id.*

137. *Id.*

138. *Wrecking Operation*, *supra* note 90, at 3.

139. See *Support Grows*, *supra* note 120, at 21 (stating key clauses in bill faced unprecedented opposition in House of Lords from sectional interests favoring Lloyd's).

the members of Lloyd's.¹⁴⁰ In fact, some MPs are also members of Lloyd's.¹⁴¹

The Lloyd's leadership supported the passage of the Lloyd's Act of 1982 by Parliament.¹⁴² A large segment of the Lloyd's market, however, opposed the bill and mustered opposition in the House of Lords.¹⁴³ While many brokers supported the bill in public in order to further its overall passage, many opposed the requirement that brokers divest themselves of ownership of managing agencies.¹⁴⁴ This divestment clause was thought by other members of the Lloyd's community to be essential to the success of the self-regulatory powers of Lloyd's.¹⁴⁵ Parliamentary petitions were sought condemning the divestment clause, notably by broker Alexander Howden's chairman Kenneth Grob.¹⁴⁶ A House of Commons committee favored the retention of the divestment clause.¹⁴⁷

The Lloyd's Committee denied that the divestment clause would upset the delicate balance of relationships within the market, arguing instead that the broker should be the agent of the insured and not the agent of the underwriter.¹⁴⁸ Lloyd's argued that the divestment clause would regularize the relationship between a broker, the broker's clients, and the underwriting capital base of the market.¹⁴⁹ The brokers who opposed the divestment clause argued that the conflicts of interest being singled out by reformers were arbitrary in a market full of such conflicts.¹⁵⁰ Further, the brokers argued that such a market created a unique revenue-earning environment by maintaining existing

140. See RAPHAEL, *supra* note 1, at 245 (describing Lloyd's relationship with Tories as "traditionally cosy").

141. See Jonathan Prynne, *Lloyd's Regulation Move Fails*, *TIMES*, June 28, 1994, available in LEXIS, News Library, NON-US File (stating 200 peers in House of Lords thought to be Names).

142. See *Wrecking Operation*, *supra* note 90, at 3 (describing Lloyd's leadership steering bill through Parliament).

143. See *Support Grows*, *supra* note 120, at 21 (stating key clauses in bill faced unprecedented opposition in House of Lords from sectional interests favoring Lloyd's).

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

relationships in the market.¹⁵¹

The Lloyd's Act of 1982 passed with the divestment clause intact.¹⁵² The substance of the law incorporates Fisher's reforms.¹⁵³ The Council of Lloyd's¹⁵⁴ was created with sixteen working members, eight external Names, and three nominated members.¹⁵⁵ The Council was given powers over the management of the Society's affairs and regulation of its members and their conduct.¹⁵⁶ The Council was also given broad power to adopt bylaws for any purpose, including making provision for and regulating the admission, suspension, and disciplining of members of the Society, Lloyd's brokers, underwriting agents, and others.¹⁵⁷

The Lloyd's Act of 1982 was unable to prevent scandal, however.¹⁵⁸ Kenneth Grob of Alexander Howden, an opponent of change during the Parliamentary hearings, was implicated only a

151. *Id.*

152. See *Self-Regulation at Lloyd's*, FIN. TIMES, Sept. 23, 1982, at 20 (explaining decision that brokers' and managing agents' functions must be separated). "At one time, the majority of both managing agents and members' agents were owned by brokers. Under the Lloyd's Act of 1982, brokers were required to divest their managing agencies but could retain their members' agencies." *Understanding Lloyd's*, *supra* note 20 at 4.

153. Lloyd's Act, 1982, ch. 14, §§ 10-11 (Eng.).

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. See *Self-Regulation at Lloyd's*, *supra* note 152, at 20.

[R]arely [has a scandal] penetrated so deeply as [the Alexander Howden affair]. Not only are the amounts of money extremely large — Alexander and Alexander has alleged that as much as \$55m may have been misappropriated over a period of years — but one of the leading firms of Lloyd's brokers is involved, and in suspending Mr. Ian Posgate, Lloyd's has taken severe disciplinary action against one of the members of its own ruling committee.

Another strange aspect is that several of the key figures involved took a leading part in the presentation of evidence last year to a Parliamentary Committee, during the process of enactment of new legislation to reinforce the self-regulatory powers of Lloyd's. . . .

In the event it was decided that [the] functions [of broker and managing agent] must be separated. That decision is clearly justified by recent events. Even so, it is bound to rankle in political circles that such prominent figures in the parliamentary proceedings should now be the subject of serious allegations involving precisely the misuse of underwriters' funds over which they had control. . . .

In th[e] circumstances the market must either take shelter beneath an umbrella of statutory controls or, as we would prefer, face up to the problems and costs of a much more sophisticated structure of self-regulation.

few short months after the passage of the Lloyd's Act in one of the worst scandals in Lloyd's history.¹⁵⁹ Grob was accused of misappropriation of underwriters' funds, precisely the ill that the divestment clause sought to prevent.¹⁶⁰ The misappropriated funds totalled nearly US\$55 million.¹⁶¹

C. *The Late 1980's: Downturn in the Lloyd's Market*

Insurance is a cyclical business,¹⁶² and Lloyd's proved not to be immune to the cycle.¹⁶³ The string of disasters that occurred in the late 1980's were damaging to Lloyd's.¹⁶⁴ Because of the extent of the catastrophe coverage provided at Lloyd's by the London Excess of Loss¹⁶⁵ ("LMX" or "spiral") market, losses were great.¹⁶⁶ Other damage stemmed from the long-tail¹⁶⁷ market where open-year¹⁶⁸ claims increased under pollution and asbestosis policies.¹⁶⁹ The resulting cash calls to Names to pay for these losses led to an unprecedented amount of litigation.¹⁷⁰

1. The Insurance Cycle

The insurance industry operates in cycles.¹⁷¹ Premium rates

159. *Id.*

160. *Id.*

161. *Id.*

162. See BUSINESS PLAN, *supra* note 6, at 6 (stating insurance is highly cyclical).

163. See Dacey, *supra* note 46, at 1 (stating Lloyd's not immune to cycle).

164. See Barnes, *supra* note 7, at 78 (describing effects of catastrophes).

165. See *id.* at 78 (explaining LMX market).

166. *Id.*

167. See *id.* (explaining "long-tail" market).

168. See RAPHAEL, *supra* note 1, at 206 (explaining that open-years are years of account that cannot be closed due to potential claims under policies whose terms have expired).

169. See *id.* at 99 (describing effect of asbestos claims). "[A]sbestos in all but the highest dust concentrations is an insidious killer." *Id.* at 100. General coverage policies written over many years have been interpreted broadly by U.S. courts. Interview with Dennis Mahoney, Deputy Chairman, Alexander Howden Group, London (July 20, 1994). The result has been seemingly endless litigation. *Id.* Without tort reform in these areas, there may be a massive redistribution of wealth at the cost of the entire insurance industry. *Id.* "The magnitude of losses faced by insurers that issued coverage to asbestos manufacturers was illustrated by a 1993 decision announced by CNA Financial Corp. and Chubb Corp. to collectively pay over \$3 billion to Fibrebrand Corp. to settle asbestos personal injury claims." Ruthe Gastel, *Occupational Disease: Insurance Issues*, Insurance Information Institute Reports, June 1994.

170. See RAPHAEL, *supra* note 1, at 7-8 (discussing Names' suits).

171. Kevin Pratt, *Lloyd's Ensures a Brighter Future*, SUNDAY TIMES, Feb. 12, 1995, available in LEXIS, News Library, NON-US File (discussing insurance cycle).

increase, or harden, during periods when demand is increasing but capacity, the amount of capital available to underwrite risk, is low.¹⁷² As profits increase, capacity also increases due to greater participation in the market.¹⁷³ As a result, the market turns soft and premium rates go down as underwriters slash prices in an effort to compete for business.¹⁷⁴ When prices become too low, capacity is again driven from the market and prices again begin to harden.¹⁷⁵

A soft market is not good for business.¹⁷⁶ As capacity increases, and business becomes more competitive, incentives rise to repackage already insured risks for reinsurance in order to generate profits in the form of commissions.¹⁷⁷ The incentives also rise to accept unreasonable risks in order to generate underwriting profits.¹⁷⁸ When the series of disasters occurred in the late 1980's, the capacity of the market was nearly at its peak level.¹⁷⁹

2. Disasters

The series of accidents and natural disasters that occurred in the late 1980's led to record losses.¹⁸⁰ First, the Piper Alpha oil rig explosion in the North Sea killed 165 people and caused millions of dollars in damages.¹⁸¹ Soon after, Hurricane Hugo hit the Eastern seaboard of the United States, causing over US\$5 billion in damages.¹⁸² Between 1987 and 1990, the unprecedented number of disasters included the Exxon Valdez oil spill in Alaska,¹⁸³ the earthquakes in San Francisco and Australia,¹⁸⁴ a

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. Adrian Ladbury & Stacy Shapiro, *London Market Competition is Returning*, Bus. INS., Jan. 16, 1995, available in LEXIS, News Library, US File.

177. See Barnes, *supra* note 7, at 78 (arguing business written in LMX market when no 'real' business available due to high capacity).

178. *Id.*

179. *Id.*

180. See *id.* (describing effects of catastrophes). "[A series] of catastrophes . . . racked up more than \$40 billion in insurance losses between 1987 and 1990." *Id.* at 174; see also BUSINESS PLAN, *supra* note 6, at 2 (stating current results worst in Lloyd's history).

181. RAPHAEL, *supra* note 1, at 173.

182. *Id.* at 74.

183. *Id.*

184. *Id.*

typhoon in Japan,¹⁸⁵ and windstorms in Northern Europe.¹⁸⁶ The disasters precipitated losses in the worldwide insurance market of over US\$40 billion.¹⁸⁷

Lloyd's was not alone among insurers in suffering the business effects of these catastrophes.¹⁸⁸ As a worldwide market for high-risk excess casualty reinsurance,¹⁸⁹ however, Lloyd's may have felt more pressure than the United States and continental European insurance companies.¹⁹⁰ The spiral market was that in which underwriters wrote excess casualty policies¹⁹¹ that insure catastrophic loss over and above a certain amount.¹⁹² Market professionals reinsured the risks repeatedly, each time adding a new layer of protection and each time taking a commission.¹⁹³ The practice ran counter to the principles of insurance, which demand that risk be diffused and carefully assessed.¹⁹⁴ In the insulated world of the spiral market, risks were reinsured at a level far removed from the underlying policies.¹⁹⁵ Therefore, the risks were often not fully understood by the underwriters.¹⁹⁶ Furthermore, the risks became concentrated in fewer hands as they travelled up the spiral to the small group of underwriting syndicates willing to continue to reinsure catastrophe risk.¹⁹⁷ A great deal of money was made in this area of the market until the series of catastrophes in the late 1980's toppled it.¹⁹⁸ Layers of protection disappeared and the cash calls began.¹⁹⁹

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* "Insurers all over the world were shaken" by the disasters. *Id.*

189. *See id.* at 174-75 (explaining development of Lloyd's market as specialist reinsurance market for high-level risk).

190. *See id.* (discussing reinsurance market).

191. *Id. at x.*

192. *See Barnes, supra* note 7, at 78 (explaining spiral market).

193. *See RAPHAEL, supra* note 1, at 4 (discussing basic concerns of insurance).

194. *Id.*

195. *See id.* at 176 (describing spiral market).

196. *Id.*

197. *Id.*

198. *See id.* at 178-79 (detailing expanding capacity in LMX market and ultimate demise).

199. *Id.*

3. Further Flaws in the Market

The spiral market was but one of Lloyd's difficulties.²⁰⁰ Other structural flaws in the market augmented the problems at Lloyd's.²⁰¹ These problems arose with respect to the reinsurance-to-close ("RITC") and open-year situations.²⁰²

a. Reinsurance-to-Close

A syndicate purchases RITC at the end of one year to reinsure any risks underwritten in policies under which claims may still be forthcoming after the end of the year.²⁰³ The underwriter looks to his or her book of business at the end of each year and makes a determination of possible claims incurred but not reported that a syndicate may face under certain outstanding policies.²⁰⁴ The underwriter then purchases reinsurance to cover those risks so the accounts can be "closed" for the year.²⁰⁵ The next year's underwriting Names will, in theory, not be subject to liability for those claims.²⁰⁶

The difficulty lies in determining how much reinsurance to buy to close out the year.²⁰⁷ The cost of the reinsurance premiums may make the difference between underwriting profits or losses for the syndicate, so the underwriter has an incentive to

200. See RAPHAEL, *supra* note 1, at 205-06 (describing open-year and reinsurance-to-close problems).

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. See *id.* (explaining potential liabilities based on insufficient RITC and open years).

The three year accounting system is integral to Lloyd's and a way to delineate the extent of claims on policies written. It adds stability and finality and has given rise to a specialized coverage known as "reinsurance to close." At the end of the year, the accounts of the year three years previous are "closed" and reinsurance procured on unsettled liabilities. Reserves are kept against known claims and a certain amount designated for insured risks which have taken place but which have not yet been reported. This category of expected losses is known as "incurred but not reported" or IBNR. It represents a "tail" of unmatured liabilities and has for several years been a particular problem, as asbestos and environmental coverage claims carry with them a long "tail" and much uncertainty.

Understanding Lloyd's, *supra* note 20 at 5.

207. *Id.* at 205.

make a low estimate.²⁰⁸ If he guesses wrong, and later years bring unanticipated claims under the policy, the current underwriting Names on the syndicate must pay the claim regardless of whether they were members of the syndicate, or even of Lloyd's, at the time the policy was written.²⁰⁹

b. Open-Years

Another difficulty with reinsurance-to-close arises if the underwriter cannot make a reasonable guess as to the possible forthcoming claims or cannot afford the reinsurance to cover those anticipated claims.²¹⁰ In that situation, the years are left "open" and it becomes impossible for the syndicate's Names to resign from Lloyd's.²¹¹ Any Name on a syndicate with open-years must remain in the market until all valid claims are paid.²¹² Syndicates underwriting risks for latent disease and industrial pollution, called long-tail risks, face claims that arise under casualty policies written as long as forty to fifty years ago.²¹³ There are Names who have open-years from decades ago²¹⁴ and who may be liable for large asbestosis and pollution claims based on awards given by the U.S. courts under general liability policies.²¹⁵

4. Litigation

Names who pledged personal, non-liquid assets, such as their homes²¹⁶ in order to join Lloyd's during a period of enormous expansion in the market were faced with large claims.²¹⁷ Despite their acceptance of unlimited liability, many Names considered the risks underwritten for their accounts to be beyond

208. RAPHAEL, *supra* note 1, at 205.

209. *See id.* at 205-06 (explaining potential liabilities based on insufficient RITC and open years).

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.*

214. *See id.* at 205-06 (describing results of claims on forty-year old policies).

215. *See* Robert Stowe, *Paying the Yankee Piper*, *FIN. WORLD*, July 6, 1993, at 28 (discussing U.S. court awards for asbestos and pollution claims). "The Keene Corp., facing 98,000 pending claims was granted an injunction barring it from future judgements. . . . To date, 17 other former asbestos manufacturers have declared bankruptcy." Ruthie Gastel, *Occupational Disease: Insurance Issues*, Insurance Information Institute Reports, June 1994.

216. RAPHAEL, *supra* note 1, at 49.

217. *See* Barnes, *supra* note 7, at 78 (describing Names' and their losses).

what they had been prepared to accept when they joined.²¹⁸ These Names had once enjoyed the cachet that came with being "at Lloyd's."²¹⁹ When the periodic checks they received were replaced by more frequent calls for larger amounts of money, many Names sued.²²⁰

These Names, who were recruited in the 1980's, claim the working members recruited them with malicious intent, knowing that the long-tail asbestosis and pollution claims were imminent and requiring extra capital to diffuse the costs of the anticipated claims.²²¹ Names allege they were fraudulently induced to join Lloyd's without being adequately informed of the risks.²²² They also allege breach of the duty of care on the part of managing agents placing risk for their accounts.²²³ The Names Defence Association²²⁴ claims to have evidence that the problem with large claims arising under long-tail policies was brought to the attention of the Lloyd's Council in the early 1980's.²²⁵ The litigation costs to all parties resulting from these disputes have

218. See RAPHAEL, *supra* note 1, at 206 (describing horror Names felt upon discovery of extent of their liabilities).

219. See MANTLE, *supra* note 20, at 5 (describing appeal of Lloyd's membership).

220. RAPHAEL, *supra* note 1, at 218 "[As] the losses at Lloyd's escalated, the 30 percent of Names on whom 70 percent of the losses had fallen were faced by a choice: pay up or fight. Many determined to sue . . ." *Id.*

221. See *Insider Dealing Victims*, *supra* note 25, at 25 (discussing Names' allegations).

222. *Deeny v. Gooda Walker Ltd.*, 1994 P.14 (Eng. Q.B.) (Oct. 4).

223. *Id.*

224. Stacy Shapiro, *Lloyd's Regulation Hit: Execs Ask Parliament for Time to Complete Current Reforms*, *BUS. INS.*, Feb. 13, 1995, at 3.

225. See *id.* at 3 (discussing Names organization's submissions to Parliament).

[The Lloyd's Names Defence Association] report is a chronological diary of the information and intelligence which had been collected by and was known to Lloyd's during the last several decades and it also details what Lloyd's did as a result of that information. By inference, therefore, it also provides the means to determine what Lloyd's should have done but did not. Each entry in the final report is a factual extract. . . . A layman reading this report is drawn to only one conclusion, that from around the mid 1970's the key working Names and Council members at Lloyd's concealed material information from the mass of underwriters and external Names. (It is this long continuing concealment of material information which allowed many subsequent malpractices to develop throughout the Lloyd's market. These included such abuses as misleading time and distance policy accounting, the LMX spiral, and preferential trading privileges for influential working Names. . . .).

Financial Services Regulation, Minutes of Evidence Before the Treasury and Civil Service Committee, House of Commons, Session 1994-95 (Feb. 1, 1995) (Letter from Names Defence Association) [hereinafter Names Defence Association Letter].

been substantial.²²⁶

5. Lack of Adequate Regulation

A pattern that developed over time at Lloyd's with respect to self-governance contributed to the current problems.²²⁷ The market professionals were wary of publicity, and a certain air of mystery attached itself to the workings of the Lloyd's market.²²⁸ The market often functioned smoothly and the market professionals were accustomed to making a profit.²²⁹ The leaders were advocates of a *laissez faire* market who preferred to manage their own affairs and to correct their own mistakes.²³⁰ In practice, this meant there was little or no regulatory oversight of the market.²³¹ Lloyd's market professionals were not required to and did not disclose much information to the external Names.²³² The system relied in large measure on trust.²³³ This system later proved to be inadequate to protect the interests of the Names, as is evidenced by their substantial losses.²³⁴

After the Lloyd's Act of 1982 was passed, the Alexander Howden affair was not the only scandal that occurred in the market.²³⁵ Names' profits were skimmed off into offshore accounts by the most senior and respected members of the Lloyd's community.²³⁶ The best profit-making syndicates were all filled by

226. See RAPHAEL, *supra* note 1, at 220 (stating number of Names suing Lloyd's, possible length of litigation, and cost per hour of City's leading lawyers).

227. See *id.* at 62 (discussing traditional *laissez faire* attitude of Lloyd's leadership).

228. See *id.* at 43 (discussing secrecy surrounding Lloyd's).

229. *Id.*

230. See *id.* at 62 (discussing traditional *laissez-faire* attitude of Lloyd's leadership).

231. See *Insider Dealing Victims*, *supra* note 25, at 25. "For a long period of time self-regulation became voluntary regulation or no regulation at all." *Id.*

232. See RAPHAEL, *supra* note 1, at 43 (describing non-working Names' ignorance of events at Lloyd's).

233. See *id.* at 57 (describing degree of trust and criticizing market practices).

234. See *id.* at 57 (criticizing market practices).

235. See *Self-Regulation at Lloyd's*, *supra* note 152, at 20. "Lloyd's is looking not so much accident prone as chronically under-regulated." *Id.*

236. See RAPHAEL, *supra* note 1, at 86 (discussing Peter Cameron-Webb affair).

The investigators appointed by Lloyd's to inquire into the PCW frauds told [Lloyd's] . . . that it was apparent to them that many members of Lloyd's in senior positions had only the sketchiest notion of their legal obligations to act at all times in the best interests of their Names, and not to make secret profits at their expense.

Id. at 86.

insiders, according to some allegations.²³⁷

Furthermore, the "run-off" reinsurers,²³⁸ such as the Outhwaite syndicate,²³⁹ that specialized in reinsurance-to-close for asbestosis²⁴⁰ policies, exposed Names to extraordinary amounts of risk.²⁴¹ The financial consequences were devastating to some Names.²⁴² Some at Lloyd's seemed unaware of these matters until losses had mounted.²⁴³ The measures taken only attacked problems after they had occurred.²⁴⁴ Lloyd's leadership never took the appropriate preventive measures.²⁴⁵

Some commentators maintain that if Lloyd's is to continue its tradition of never failing to pay a valid claim²⁴⁶ and, if Lloyd's intends to continue doing business in the future, confidence in the market must be fully restored.²⁴⁷ Lloyd's leaders agree that the problems must be addressed in order to continue to attract

237. See *Insider Dealing Victims*, *supra* note 25, at 25 (reciting Names' allegations).

Sorting and analysing the final [Names Defence Association] project database reveals many damning facts. For example, for many years, virtually every managing agency ran a series of parallel and baby syndicates, all doing essentially the same type of business. (These enabled unscrupulous underwriters to abuse external Names by, for example, collecting several sets of management fees and expenses for essentially the same business . . .).

Names Defence Association Letter, *supra* note 225 at 56.

238. RAPHAEL, *supra* note 1, at 126 (describing run-off policies).

239. *Id.*

240. See *id.* at 111 (describing syndicates specializing in asbestos).

241. See *id.* at 99 (describing effect of asbestos claims).

242. *Id.*

243. See *id.* at 131 (stating underwriter believed risk was good one at time).

244. See *id.* at 133 (describing actions taken by members' agents after extent of Outhwaite losses began to become known).

245. See *id.* at 149 (discussing failed effort by Lloyd's deputy chairman to warn of asbestos risks in 1982).

Who goes bust will be decided by the courts. But it is, at the very least, disturbing that so few managing and members' agents followed the advice of Lloyd's deputy chairman, Murray Lawrence, in his letter of 18 March 1982 that they should 'inform their Names of their involvement with asbestosis claims and the manner in which their syndicates' current and potential liabilities have been covered.' The failure to do this led many thousands of unwitting Names to join long-tail syndicates throughout the 1980's. Many professionals at Lloyd's realized the dangers. Very few outsiders did.

Id.

246. Stacy Shapiro, *Lloyd's Will Continue Paying 'All Valid Claims'*, *BUS. INS.*, May 23, 1994, at 29.

247. See BUSINESS PLAN, *supra* note 6, at 6 (describing profit opportunity at Lloyd's). "Names will only continue to underwrite at Lloyd's and new capital providers will only join if there is a convincing case that Lloyd's syndicates can now achieve levels of return on capital that compare favourably with other investment opportunities." *Id.*

future capital providers to underwrite risks.²⁴⁸ Along with the April 1993 announcement of the worst losses in its three hundred year history,²⁴⁹ Lloyd's announced a Business Plan to address these problems.²⁵⁰

II. REGULATION AT LLOYD'S

The current leadership is still reticent regarding certain matters Lloyd's faces during this crisis.²⁵¹ They do admit, however, the need for change at Lloyd's.²⁵² The old regulatory system contributed to the crisis.²⁵³ The current leaders acknowledge the benefits of reform,²⁵⁴ even if Lloyd's leaders have not been traditionally inclined towards it.²⁵⁵ The leadership initiated changes within the structure of self-regulation at Lloyd's.²⁵⁶ Yet, critics question the efficacy of the self-regulatory system.²⁵⁷

248. See *The End of the Name*, *ECONOMIST*, Sept. 18, 1993, at 107 [hereinafter *End of the Name*] (discussing advent of corporate capital).

249. See Stephenson, *supra* note 6, at D1 (discussing announcement of losses and Business Plan).

250. *Id.*

251. See Sarah Bagnall, *Poker Game Will Determine Future of Divided Lloyd's*, *TIMES*, Feb. 15, 1995, available in LEXIS, News Library, NON-US File [hereinafter *Poker Game*] (discussing negotiating stances of interested parties to any possible settlement).

252. See Shapiro, *supra* note 224, at 3 (discussing Lloyd's leaders testimony in Parliament).

253. *Id.*

254. *Id.*

Mr. Radice: The market is basically changing, is that right? *Mr. Rowland*: Enormously. I think one of the enormously healthy things which we have done — and I mean “we” the market helped by our regulatory colleagues laying down the rules — is to blow the doors of the market open to a different form of capital. If we are analysing the past as to what went wrong, it is sad to have to say so but the old capital was weak and members' agents representing that capital did not exercise the discipline on the market they should have done, because it is after all capital which has the strongest influence in terms of conduct of anything which it owns or it should have.

Financial Services Regulation, Minutes of Evidence Before the Treasury and Civil Service Committee, House of Commons, Session 1994-95 (Feb. 13, 1995) (Testimony of David Rowland, Chairman of Lloyd's of London) [hereinafter Rowland].

255. RAPHAEL, *supra* note 1, at 68. One former chairman at the time of the Fisher report said:

[IF] the people at Lloyd's had to be dragooned, policed and watched at every turn; if it really came to the point where one expected good faith, honesty and decency to be the exception rather than the rule, then one might well wonder whether it was worth carrying on at all.

Id.

256. See BUSINESS PLAN, *supra* note 6, at 30 (describing new regulatory regime).

257. See Jonathan Prynne & Sarah Bagnall, *Lords Fuel Lloyd's Debate*, *TIMES*, June 30,

The Names Association has pressed the need for an independent regulatory organization that would provide protection for the Names similar to that provided by the Securities and Investment Board ("SIB").²⁵⁸ Parliamentary hearings were held in February 1995 to re-examine the question of whether Lloyd's should be allowed to continue to regulate itself.²⁵⁹

A. *The Business Plan and the Self-Regulatory System at Lloyd's*

The Business Plan institutes changes that affect the process of adopting a new regulatory regime.²⁶⁰ The first-time introduction of limited liability corporate capital and the development of the run-off reinsurance company, Equitas, are among the biggest changes.²⁶¹ The question of solvency and the continued litigation by Names are further issues being addressed by Lloyd's leadership.²⁶²

1. The Business Plan

The regulatory climate at Lloyd's today is changing, though currently still within the confines of the self-regulatory system guaranteed by the Lloyd's Act of 1982.²⁶³ At the start of 1993, a new system of governance was adopted by the Council.²⁶⁴ Four months later, in April 1993, the changes were detailed in the Business Plan.²⁶⁵ The governing Council is now composed of fewer committees.²⁶⁶ There are two new boards.²⁶⁷ The first is a Market Board that administers the daily business of the market,

1994, available in LEXIS, News Library, NON-US File (describing calls in Parliament for end to self-regulation at Lloyd's). "[Self-regulation] at Lloyd's has been almost non-existent in recent years and market abuses have flourished." Names Defence Association Letter, *supra* note 225, at 56.

258. Sarah Bagnall, *Lloyd's Names Call for New Regulatory Regime*, TIMES, Dec. 5, 1994, available in LEXIS, News Library, NON-US File; see Creaven, *supra* note 92, at S291 (describing SIB).

259. William Gleeson, *Lloyd's Top Brass Face Grilling by MPs*, INDEPENDENT, Feb. 6, 1995, at 25. The report of the Treasury Committee conducting the inquiry is not yet available. Hart, *supra* note 12, at 31.

260. BUSINESS PLAN, *supra* note 6, at 30 (discussing new regulatory regime).

261. *Id.* at 3-5 (summarizing features of Business Plan).

262. *Id.*

263. See *Time to Complete*, *supra* note 252, at 3 (discussing Lloyd's leaders' testimony on current regulation).

264. BUSINESS PLAN, *supra* note 6, at 2.

265. See *id.* at 15 (detailing new system of governance).

266. *Id.*

267. *Id.*

and the other is a Regulatory Board that oversees regulatory matters.²⁶⁸

The stated goal of the Regulatory Board is to emulate as closely as possible the role of an outside regulatory agency in order to restore the confidence of future capital providers.²⁶⁹ The new regulatory regime must reconcile the varied interests at work in the marketplace as well as the feeling among aggrieved Names that failure of regulation is at the root of so many of the current problems.²⁷⁰ The success of the regulatory changes is contingent on the success of the Business Plan's other ventures.²⁷¹

2. Factors Affecting the Scope of Regulatory Change

Many factors affect the scope of the regulatory changes at Lloyd's.²⁷² The new role of limited liability corporate capital²⁷³ in the marketplace is a major development,²⁷⁴ as is the effort to create a run-off reinsurance company for old-year risks.²⁷⁵ Other problems include ensuring Lloyd's solvency²⁷⁶ and confronting

268. *Id.* at 30.

269. *See id.* (discussing new regulatory regime).

270. *See* Hart, *supra* note 12, at 31 (discussing Names anger at lack of regulation).

271. *See* BUSINESS PLAN, *supra* note 6, at 3-4 (summarizing Business Plan).

272. *Id.*

273. *See id.* at 56-57 (discussing first-time admission of limited liability incorporated capital vehicles as providers of underwriting capacity at Lloyd's).

There was an immediate scramble among the large financial institutions, Lloyd's brokers and agents, to launch corporate vehicles. Although a few fell by the wayside, most were launched successfully. Those which were withdrawn were, by and large, those which were overambitious and sought to set up funds of hundreds of millions of pounds. A few, such as LIMIT and Angerstein, went through despite raising funds which fell short of their target. The most popular were the smaller vehicles and those which were strongly tied to a successful and respected managing agency with guaranteed access to choice syndicates, such [as] Hiscox.

To date, all the Corporate Names have been set up as investment trusts. An investment trust is not a trust properly so-called but a limited liability company, the shares of which must be listed on the London Stock Exchange. Shareholders own shares in the company, not in its underlying investments.

Challenge at Lloyd's, *supra* note 70, at 5.

274. *Id.*

275. Ralph Atkins, *Payment for Past Excesses: Ralph Atkins on Equitas, A New Company to Take Over Billions of Pounds of Old Liabilities at Lloyd's*, *FIN. TIMES*, Feb. 8, 1995, at 20.

276. Clare Sambrook, *Lloyd's Future is Now the All-Risks Question: Is the Insurance Market Solvent? Clare Sambrook Hears its Embattled Chairman Discuss the Unthinkable*, *DAILY TELEGRAPH*, Feb. 11, 1995, at 2 (discussing solvency at Lloyd's).

the continuing litigation.²⁷⁷

a. Corporate Capital

A change that affects both the Market and the Regulatory Board is the admission of limited liability corporate capital to the Lloyd's market.²⁷⁸ The admission of corporate capital runs contrary to the traditions of the past and is evidence of the maturation of the marketplace.²⁷⁹ The April 1993 Business Plan explained the need for new capital in order to keep the market active.²⁸⁰ Limited liability corporate membership vehicles were developed by many of the City's merchant and investment banks, some in conjunction with brokers or managing agents,²⁸¹ and other corporate capital vehicles were U.S. institutions.²⁸²

The basic form of the new corporate capital vehicles is an investment trust.²⁸³ One-half of a trust's capitalization is invested in underwriting syndicates and the other half in investments outside Lloyd's in order to act as a guarantee for the funds placed on deposit at Lloyd's.²⁸⁴ The new corporate capital provided for the 1995 underwriting year is UK£331 million, giving Lloyd's a total new capacity of UK£593 million.²⁸⁵

277. See Robert Tyerman, *Lloyd's Nears Names Offer*, SUNDAY TELEGRAPH, Feb. 19, 1995, at 1 (discussing Names' suits against Lloyd's).

278. See BUSINESS PLAN, *supra* note 6, at 56-57 (discussing first-time admission of limited liability incorporated capital vehicles as providers of underwriting capacity at Lloyd's).

279. *End of the Name*, *supra* note 248, at 107.

280. See BUSINESS PLAN, *supra* note 6, at 56-57 (discussing first-time admission of limited liability incorporated capital vehicles as providers of underwriting capacity at Lloyd's).

281. See Richard Lapper, *Trusts Begin to Issue Lloyd's Prospectuses*, FIN. TIMES, Oct. 22, 1993, at 10 (discussing investment trusts at Lloyd's).

282. See *U.S. Investors Provide Lloyd's with New Capital*, FIN. POST, Dec. 22, 1994, at 6 (discussing U.S. corporate investment at Lloyd's).

283. See Kevin Pratt, *Lloyd's Ensures A Brighter Future*, SUNDAY TIMES, Feb. 12, 1995, available in LEXIS, News Library, NON-US File (discussing form of corporate capital vehicles investing at Lloyd's).

As an extension of the corporate capital idea, flexibility has been added with the approval of a scheme allowing corporate vehicles owned by a single investor ("corporate syndicates") and set up to invest in a single syndicate only. New corporate syndicates will be permitted on a "stand-alone" basis. Agencies are not allowed to move to a single member basis but are permitted to set up parallel syndicates.

Challenge at Lloyd's, *supra* note 70, at 9.

284. *Id.*

285. William Gleeson, *Lloyd's Nets Pounds 593m*, INDEPENDENT, Dec. 17, 1994, at 14.

Traditional Names have also been given the opportunity to incorporate in order to take advantage of the new limited liability regime.²⁸⁶ Shares in syndicates are to be traded like stock in an effort to release their inherent value.²⁸⁷ Some speculate that the entire market will eventually consist of limited liability vehicles of one form or another.²⁸⁸

The impact on the regulatory process of these incorporated vehicles, particularly the large investment trusts run by professional managers, has already been large.²⁸⁹ The corporate capital providers are accustomed to a different regulatory regime, one involving far more transparency in the marketplace.²⁹⁰ The new rulemakers have emphasized the needs of the corporate capital in their public statements about the increased disclosure under the new regulatory regime.²⁹¹

b. The Equitas Project

Another important initiative developed by the Business Plan is the Equitas project, formerly known as NewCo.²⁹² Equitas is a response to the problem of Names' continuing liability due to open years of account.²⁹³ Equitas will be a reinsurance run-off company that will allow Names eager to resign from Lloyd's to purchase reinsurance ending their liability for pre-1985 long-tail liability claims.²⁹⁴ The goal is to achieve economies of scale and

286. See Stowe, *supra* note 215, at 28 (discussing capital to be provided by newly incorporated Names).

287. See *Lloyd's May Allow "Names" to Trade Syndicate Shares: FT*, AGENCE FRANCE PRESSE, Feb. 19, 1994, available in LEXIS, News Library, NON-US File (discussing trading Lloyd's syndicate shares).

288. See *End of the Name*, *supra* note 248, at 107 (discussing role of corporate capital).

289. See Sarah Bagnall, *Lloyd's Sets New Voting Rights*, TIMES, Dec. 10, 1993, available in LEXIS, News Library, NON-US File (discussing adoption of proportional voting rights, reflecting introduction of corporate capital).

290. See *End of the Name*, *supra* note 248, at 107 (discussing corporate capital providers' expectations regarding regulation of marketplace).

291. *New Name for the Game*, BANKER, Jan. 1994, available in LEXIS, News Library, NON-US File. "[T]hose at Lloyd's charged with introducing corporate capital have concentrated on the needs and requirements of the traditional corporate finance market" *Id.*

292. See Atkins, *supra* note 275, at 20 (discussing Equitas project). "The aim is that by the end of this year, liabilities on insurance policies sold in 1985 and before, together with sufficient reserves to meet claims, will be 'reinsured' — or moved — into Equitas" *Id.*

293. *Id.*

294. *Id.*

to provide negotiating leverage by consolidating the claims-handling process.²⁹⁵ Consolidation is also aimed at improving cash-flow and aiding in long-term investment strategy.²⁹⁶

Equitas will provide important leverage in negotiations with litigating Names, who can be offered a way to cap their losses through Equitas.²⁹⁷ Further, corporate capital must be protected from liability for these old claims.²⁹⁸ Because the value of anticipated claims for latent disease and pollution are still unknown, however, the venture contains risks.²⁹⁹ If Equitas' reserves prove insufficient to meet the claims, individual Names, or even corporate vehicles participating in certain syndicates, could be forced to assume the liabilities.³⁰⁰ The future of Lloyd's as an active business is considered by many market professionals to depend on the success of the Equitas venture.³⁰¹ Despite a current return to buoyant trading and even some underwriting profits in recent months, such as in the marine market, where premiums are hardening,³⁰² the project is far from finished.³⁰³

c. The Solvency Issue

The Lloyd's market is subject to outside oversight, which includes the solvency tests administered each Fall by the Department of Trade and Industry³⁰⁴ ("DTI") under the Insurance

295. *Id.*

296. *Id.*

297. Atkins, *supra* note 275, at 20.

298. See *End of the Name*, *supra* note 248, at 107 (discussing corporate capital exposure to long-tail claims).

299. *Id.* at 107. "[Lloyd's] is doing its best to assure [corporate investors] that they will not be stung by past long-term liabilities. It hopes to set up [Equitas], a central vehicle to take on all pre-1985 liabilities" *Id.*

300. *Id.* at 107. "[Lloyd's promise not to levy against new corporate capital members without a vote] . . . gives corporate investors some reassurance that they will not be stuck with the bill for past losses. Yet, [if losses are too great] corporate members may have to provide something extra." *Id.*

301. Ralph Atkins, *People: Hutter up to Speed on Lloyd's-Speak: Ralph Atkins Meets Heidi Hutter, the Cool-Brained Diplomat Behind the Development of Equitas*, FIN. TIMES, Feb. 20, 1995, at 10 [hereinafter *Up to Speed*].

302. Janet Porter, *Marine Insurance Recovery Points to Profit for Lloyd's*, J. OF COM., Feb. 2, 1995, at A7.

303. See *Up to Speed*, *supra* note 301, at 10 (discussing Equitas project).

304. Creaven, *supra* note 92, at S291-92 (discussing role of DTI as regulatory body).

Companies Act of 1982.³⁰⁵ The first solvency test is an assets against projected liabilities test.³⁰⁶ The test was passed by Lloyd's in recent years through certain creative accounting measures, such as revaluing the Lloyd's Building in London and other assets, including artwork.³⁰⁷ A recent initiative by Lloyd's leadership would treat uncollected debt owed by Names for claims as assets of Lloyd's.³⁰⁸ This practice mirrors the practice of banks that treat recoverable debts as assets, and may make it easier for Lloyd's to pass its solvency tests.³⁰⁹

The second test is performed at the Name level.³¹⁰ Each Name must show that his or her underwriting assets at Lloyd's are sufficient to meet his or her underwriting liabilities.³¹¹ Due to the huge losses of recent years and the reluctance of some Names to pay more cash calls, this test could be a more difficult one to pass.³¹²

A recent proposed rule change would require any money

305. Insurance Companies Act, 1982, ch. 50 (Eng.); see Sambrook, *supra* note 276, at 2 (discussing solvency tests).

The first [solvency test] weighs up all Lloyd's assets against expected claims, a test Mr. Rowland told the select committee "we passed with a substantial margin." In the second, each of the 30,000-odd Names, from boxer Henry Cooper to entrepreneur Sir Freddie Laker and Mr. Rowland himself, must show sufficient assets to pay claims on policies issued on their behalf. If individual Names cannot, as 9,000 could not in December 1993, Lloyd's central fund — made up of levies on all the Names — makes up the difference.

Id.

306. *Id.*

307. Stacy Shapiro, *S&P Sizes Up Lloyd's Survival of the Fittest Syndicates Leads to a Stronger Market*, *BUS. INS.*, Sept. 26, 1994, at 65.

Lloyd's has mortgaged its assets and manipulated accounting figures to pass this test. Specifically, it revalued its assets, including its building, works of art and publishing subsidiary Lloyd's of London Press Ltd. to boost its assets by 300 million pounds (\$472.1 million). In addition, . . . the DTI allowed Lloyd's to reduce its 1991 global loss by eliminating 'double counting' from its results. This occurs when a syndicate is reinsured by another syndicate and both have reserved for the same loss. . . .

Lloyd's members had to pay for the double count . . . [but] Lloyd's has been able to use 180 million pounds (\$266.4 million) of this amount as an asset

Id.

308. Ralph Atkins, *Lloyd's May Consider Names' Debts as Assets*, *FIN. TIMES*, Feb. 20, 1995, at 7.

309. *Id.*

310. See Sambrook, *supra* note 276, at 2 (discussing solvency tests).

311. *Id.*

312. *Id.*

awarded by the English courts to Names in the course of their litigation with managing and members' agents to be paid into the Premium Trust Funds³¹³ on deposit at Lloyd's until all valid claims are met.³¹⁴ The reason for the proposed change is that Lloyd's leadership fears Names will not pay their claims after they receive the awards.³¹⁵ An additional effect of the proposed rule change, however, is that funds awarded in negligence cases³¹⁶ will be kept in escrow until any legal challenges to the proposed rule change can be resolved in the courts, a process that may take several months.³¹⁷

Lloyd's argues that, in the interim, these funds may be included as assets in order to pass the second DTI solvency test.³¹⁸ The DTI's approval of the proposed rule change, however, which was expected to be easily granted, was recently delayed in order to allow closer analysis by the DTI.³¹⁹ Lloyd's has postponed its pursuit of the rule change in favor of a new settlement agreement.³²⁰ As a market analyst noted, the question is not Lloyd's solvency, but what the DTI will accept.³²¹

Solvency was a major topic at recent Parliamentary hearings on the issue of financial services regulation.³²² The House of Commons committee heard testimony from David Rowland, the Chairman of Lloyd's, during the first week of February 1995.³²³ When asked whether Lloyd's would pass its solvency tests this year, Mr. Rowland replied that, while it had once been unthinkable to imagine otherwise, there was at least a theoretical danger of insolvency.³²⁴ He also cautioned the aggressive questioners

313. See Fact Sheet 1, in INFORMATION PACK, *supra* note 35, (describing Premium Trust Funds).

314. Clare Sambrook, *Rowland Says Lloyd's Faces Solvency Worry*, DAILY TELEGRAPH, Feb. 7, 1995, at 23.

315. Helen R. MacLeod, *Names Slam Lloyd's Plans to Reroute Litigation Money*, J. OF COM., Feb. 7, 1995, at A9.

316. See *id.* (discussing recent Gooda Walker decision).

317. *Id.*

318. See Sambrook, *supra* note 276, at 2 (discussing solvency tests).

319. *Heseltine Delays Lloyd's Rule Move*, TIMES, Feb. 23, 1995, available in LEXIS, News Library, NON-US File.

320. Alfred Doll-Steinberg, *Lloyd's Names Need Offer They Cannot Refuse*, TIMES, Feb. 17, 1995, available in LEXIS, News Library, NON-US File.

321. See Sambrook, *supra* note 276, at 2 (discussing solvency tests).

322. *Id.*

323. *Id.*

324. *Id.*

about Lloyd's large role in the British economy, noting that, as more suspicions are raised about the prospect of insolvency, more Lloyd's customers will be lost to competitors.³²⁵ On January 8, 1995, Exxon switched most of its insurance renewals away from Lloyd's, one of the largest rejections of Lloyd's in recent years.³²⁶

The hearings in Parliament underscored concerns that the current system may not be effective to protect participants in the market from negligent and fraudulent acts.³²⁷ Along with solvency, the Treasury select committee conducting the review of Lloyd's examined the question of misrepresentation to Names based on inadequate disclosure, allegations of insider trading, and recruitment of Names in order to allow the market to absorb the costs of long-tail liabilities.³²⁸ It also examined the role of the DTI and the responsibility of the government, as well as the broader question of Lloyd's being allowed to continue to police itself.³²⁹

d. Litigation

Litigation by Names also influences the regulatory changes being enacted.³³⁰ The Gooda Walker Action Group, a group of litigating Names who lost a great deal of money in the LMX spiral market, won its case on appeal against its former managing agents.³³¹ The Gooda Walker plaintiffs charged that the managing agents on the Gooda Walker syndicates breached their duty of care by accepting risks they should have avoided.³³²

In their pleadings at the trial level, the plaintiffs alleged, *inter alia*, that a competent underwriter in the spiral market would have written only a limited volume or proportion of excess of

325. *Id.*

326. See Doll-Steinberg, *supra* note 320 (discussing Exxon's renewals).

327. See *Time to Complete*, *supra* note 224, at 3. "The Lloyd's executives were grilled by members of the Treasury and Civil Service Committee last week, which is investigating the adequacy and enforcement of the United Kingdom's financial services regulation." *Id.*

328. See William Gleeson, *Lloyd's Top Brass Face Grilling by MPs*, DAILY TELEGRAPH, Feb. 6, 1995, at 25 (discussing content of Parliamentary review).

329. See *Insider Dealing Victims*, *supra* note 25, at 25 (discussing hearings).

330. Doll-Steinberg, *supra* note 320. "Lloyd's reaction to the Gooda Walker decision result was to announce that it would change its rules so that Lloyd's could have first call on the money due to the litigating names." *Id.*

331. *Deeny v. Gooda Walker Ltd.*, 1994 P.14 (Eng. Q.B.) (Oct. 4).

332. *Id.* at 14.

loss business, paid close attention to vital facts, taken steps to plan its business accordingly, and obtained information regarding the nature of the risks.³³³ The Appeal Court found that the managing agents had been negligent in accepting high-risk business.³³⁴ The duty of care owed to the Names by their agents was found to have been breached, with the resultant damage totaling millions of pounds.³³⁵ The Action Group's members were recently awarded interim damages of over UK£200 million, the largest ever awarded by the British courts.³³⁶

Those Names on the Outhwaite syndicates³³⁷ who did not take part in an earlier Outhwaite suit in 1991 are also litigants.³³⁸ The House of Lords is currently reviewing their claim that, because of deliberate concealment by their managing and members' agents, they are entitled to sue on claims arising from underwriting activity in 1982.³³⁹ Such claims would otherwise be time-barred.³⁴⁰ At present, there are approximately forty-five Action Groups³⁴¹ and over 300 Lloyd's-related cases pending in the British courts.³⁴² This figure does not include the claims by U.S. Names, most of which have thus far been dismissed for lack of jurisdiction in the United States.³⁴³

333. *Id.* at 23.

[T]he [defendant's] pleading listed a number of matters which were alleged to be material when considering the standard of care to be applied in underwriting. These were as follows:

- (i) Names at Lloyd's knowingly accept unlimited liability;
- (ii) Underwriting is a risk business;
- (iii) Underwriters assume risk in consideration of premium, and it is no part of their business to reinsure all the risks that they have assumed.
- (iv) *Lloyd's Regulations had no requirements for recording aggregate exposure or calculating probable maximum loss.*

Id. (emphasis added).

334. *Id.* at 12.

335. *Id.*

336. Clare Sambrook, *Gooda Walker Names Win a Record L210m*, DAILY TELEGRAPH, Feb. 15, 1995, at 26.

337. See RAPHAEL, *supra* note 1, at 126 (discussing Outhwaite syndicate).

338. See Hart, *supra* note 12, at 31 (discussing recent Outhwaite litigation).

339. *Id.*

340. *Id.*

341. *Lloyd's Litigation-The End of the Beginning*, WILDE SAPTE LAW, Jan. 1995, at 6 [hereinafter *End of the Beginning*].

342. *Id.*

343. Susana Antunes, *Lloyd's Faces New Threat From US*, EVENING STANDARD, June 21, 1994, at 31; see *Bonny v. Society of Lloyd's*, 3 F.3d 156 (1994). "In the present case, we are satisfied that several remedies in England vindicate plaintiff's substantive rights while not subverting the United States' policies of insuring full and fair disclosure by

One result of large damage awards is that Lloyd's loses leverage in its bargaining with the Names.³⁴⁴ Lloyd's leadership has repeatedly said that it seeks a negotiated settlement of Name's claims.³⁴⁵ A settlement offer by Lloyd's leadership to all aggrieved Names totalling over UK£900 million was rejected last year as too low.³⁴⁶ Another settlement offer is to be announced soon.³⁴⁷ Lloyd's argues in favor of settlement on the theory that because the claims against agents will be paid under Errors and Omissions ("E&O") policies, the Names are, in effect, suing each other.³⁴⁸

The E&O coverage may also be insufficient to meet all the claims.³⁴⁹ The result is a rush by Names to seek redress in the courts.³⁵⁰ Counsel for the Gooda Walker Action Group stated that their strategy involved getting through the trial quickly in order to receive payment before the money ran out.³⁵¹ E&O insurers claim that the Gooda Walker Action Group has overstated the value of the award and that they will only pay UK£115 million of the interim award.³⁵² Thirty members' agencies have retained counsel and threatened to sue the E&O underwriters if they refuse to pay.³⁵³ As the Names prevail in the courts, the pressure on the Lloyd's leadership to negotiate a settlement grows.³⁵⁴ The Names Association has said that any settlement must involve caps on their maximum liability and sufficient com-

issuers and deterring the exploitation of United States investors." *Id.*; see *Roby v. Corporation of Lloyd's*, 996 F.2d 1353 (1993).

344. See Doll-Steinberg, *supra* note 320, available in LEXIS, News Library, NON-US File (discussing impact of litigation on Lloyd's bargaining position).

345. See Tyerman, *supra* note 277, at 1 (discussing new settlement offer).

346. Stacy Shapiro, *Lloyd's Bracing for Litigation After Settlement Fails*, *BUS. INS.*, Feb. 21, 1994, at 1.

347. Tyerman, *supra* note 277, at 1.

348. *BUSINESS PLAN*, *supra* note 6, at 28-29.

349. Ralph Atkins, *Lloyd's Names Win Pounds 210m Damages Payout*, *FIN. TIMES*, Feb. 15, 1995, at 22.

350. See *End of the Beginning*, *supra* note 241, at 7 (discussing strategy for *Gooda* litigation).

351. *Id.*

352. Clare Sambrook, *Gooda Names Face Shortfall of L95m*, *DAILY TELEGRAPH*, Feb. 28, 1995, at 25.

353. See Tyerman, *supra* note 277, at 1 (discussing possibility of new settlement offer).

354. See Doll-Steinberg, *supra* note 320 (discussing effect of Names' litigation on Lloyd's).

pensation for their losses.³⁵⁵

Recently, Lloyd's offered a settlement involving a cap on liabilities to some U.S. Names whose case against Lloyd's alleging fraud is still pending in a California court.³⁵⁶ Lloyd's official position is that it has always sought a negotiated settlement, but some Names suggest that recent developments in the U.K. courts have prompted the offer by Lloyd's.³⁵⁷ A ruling in November 1994 by the Appeal Court³⁵⁸ that a full hearing must be held on whether Lloyd's contravened European competition law means that Lloyd's cannot pursue non-paying Names through the courts until the cases are tried.³⁵⁹ If the cases are resolved against Lloyd's, Names may never have to pay the claims at all.³⁶⁰ Names argue Lloyd's is trying to get paid before it is too late, and some are resisting settlement, even with the cap.³⁶¹

B. *Criticisms of and Alternatives to the Present Changes*

Lloyd's has many critics, among the most vocal of which are aggrieved Names and members of Parliament.³⁶² There are several alternatives to the changes being sought under the existing statutory framework.³⁶³ These include regulation by an outside agency and repealing Lloyd's exemption from the Financial Services Act.³⁶⁴

1. Criticisms

The Chairman of the Regulatory Board was the subject of

355. See *Poker Game*, *supra* note 251 (discussing Names' demand for caps on liability); see Stacy Shapiro, *Gooda Ruling Sets Precedent*, BUS. INS., Oct. 10, 1994, at 1 (discussing sufficient payout).

356. William Gleeson, *Lloyd's Offers Cap on Liability to Names*, INDEPENDENT, Feb. 10, 1995, at 32.

357. *Id.*

358. *Society of Lloyd's v. Clementson*, 1994 P.1 (Eng. C.A.) (Nov. 10).

359. *Id.*

360. *Id.*

361. *Id.*

362. Clare Sambrook, *MP Fires Broadside at Lloyd's Watchdog*, DAILY TELEGRAPH, Feb. 14, 1995, at 24.

363. See *Insider Dealing Victims*, *supra* note 25, at 25 (discussing regulation at Lloyd's); see also *Lloyd's Facing Double Scrutiny*, *supra* note 12 at 31 (questioning whether Lloyd's should be allowed to continue to regulate itself).

364. See *Insider Dealing Victims*, *supra* note 25, at 25 (discussing regulation at Lloyd's).

criticism during the recent Parliamentary hearings.³⁶⁵ One Labour MP, Diane Abbott, accused Sir Hardcastle of being disinterested and willing to overlook anything that happened at Lloyd's before his tenure began.³⁶⁶ She specifically cited Sir Hardcastle's failure to investigate allegations that a market committee responsible for disseminating information related to asbestos claims had failed to do so and had instead used the information to its own advantage.³⁶⁷ Sir Hardcastle countered that the allegations were fully investigated and found meritless.³⁶⁸

Other critics of the self-regulatory system include Christopher Stockwell, Chairman of the Supergroup of Lloyd's Names, who claims Lloyd's leaders benefitted from insider dealing.³⁶⁹ Mr. Stockwell declined to mention anyone by name before the Treasury select committee.³⁷⁰ The Lloyd's Names' Associations' Working Party³⁷¹ ("LNAWP"), the group headed by Mr. Stockwell, has called for a regulatory regime with sanction power, a rapid and productive approach to enforcement, and the ability to compensate victims.³⁷² Additional demands of the LNAWP include proper capitalization for all Lloyd's agencies and sufficient E&O coverage, even if an agency ceases trading.³⁷³

2. Alternatives

One alternative to the present regulatory scheme might be a statutory scheme.³⁷⁴ A system similar to the U.S. Securities and Exchange Commission,³⁷⁵ an agency with broad monitoring powers exercised through disclosure requirements and prosecutorial powers to investigate fraud, is one possibility.³⁷⁶

365. See MP Fires Broadside at Lloyd's Watchdog, *supra* note 362, at 24 (describing MP's critiques of Lloyd's).

366. *Id.*

367. *Id.*

368. *Id.*

369. See *Insider Dealing Victims*, *supra* note 25, at 25 (discussing Stockwell testimony at Parliamentary hearings).

370. *Id.*

371. See Bagnall, *supra* note 258 (explaining LNAWP).

372. *Id.*

373. *Id.*

374. *No Need to End Lloyd's Self-Regulation-U.K. Official*, Reuters, Feb. 15, 1995, available in LEXIS, News Library, NON-US File [hereinafter *No Need to End Self-Regulation*].

375. See Securities Exchange Act of 1934, 15 U.S.C. § 78w (1988 & Supp. V 1993) (describing SEC's power under Act).

376. *Id.*

Under the Securities Exchange Act of 1934, in order to register securities on an exchange, issuers are required to disclose the following: any information about the issuer or a party in control or acting as a guarantor of the issuer that the Commission may require, including, *inter alia*, the organization and financial structure and nature of the business, information regarding securities management and holdings by security holders, remuneration to officers and others, material contracts, balance sheets, profit and loss statements, and any further financial statements deemed necessary by the Commission.³⁷⁷ There are further requirements for supplementary and periodic disclosure of relevant information under Section 15(d).³⁷⁸ Section 21 provides civil and criminal liabilities for violations such as trading on material non-disclosed information, or insider trading.³⁷⁹

The agency alternative was specifically rejected by British lawmakers during passage of the Financial Services Act.³⁸⁰ This alternative might find favor, however, with the corporate capital providers who are accustomed to doing business in a more transparent market atmosphere than has traditionally existed at Lloyd's,³⁸¹ and with disgruntled Names who are wary of self-regulation.³⁸² In the United Kingdom, oversight could be brought under the purview of the DTI³⁸³ or the Serious Fraud Office.³⁸⁴

Another alternative is to repeal Lloyd's exemption from the Financial Services Act³⁸⁵ and bring Lloyd's regulation in line with that of investment markets in the United Kingdom.³⁸⁶ The FSA requires that firms be authorized to do investment business in the United Kingdom.³⁸⁷ Authorization is obtained from one of the Self-Regulating Organizations³⁸⁸ ("SROs") or by a Recog-

377. Securities Exchange Act of 1934, 15 U.S.C. 78 § 12(b).

378. *Id.* § 15(d).

379. *Id.* § 21.

380. Creaven, *supra* note 92, at S285.

381. See *End of the Name*, *supra* note 248, at 107 (discussing corporate capital).

382. Hart, *supra* note 12, at 31.

383. Creaven, *supra* note 92, at S291-92.

384. See Criminal Justice Act, 1987, ch. 38 (Eng.) (enumerating powers to investigate fraud).

385. Financial Services Act (1986) § 42 (Eng.).

386. Creaven, *supra* note 92, at S285.

387. See *id.* at S291 (discussing requirements for authorization to conduct investment business).

388. Creaven, *supra* note 92, at S285.

nized Professional Body³⁸⁹ ("RPB"), which must itself be recognized by the Securities and Investment Board ("SIB").³⁹⁰ The SIB has powers to enforce compliance and to approve the rules of the self-regulating bodies.³⁹¹ Once an SRO is recognized by the SIB, however, the SRO becomes the primary regulating body.³⁹²

An SRO seeking to be recognized by the SIB, must have rules that provide adequate investor protection³⁹³ and oversee the enforcement of those rules.³⁹⁴ An SRO must provide for public representation in its governance;³⁹⁵ the ability to investigate complaints; fairness and integrity.³⁹⁶ The SRO must also be willing to provide information to the SIB and the DTI.³⁹⁷ The SIB's general functions are to decide whether members are "fit and proper" to engage in investment business, to devise means of enforcement of rules, and to create fair procedures regarding admission and punishment of members.³⁹⁸

The DTI would have a large role in monitoring Lloyd's under the FSA as the ultimate statutory authority.³⁹⁹ The DTI, however, has publicly voiced its support for the present self-regulatory system at Lloyd's.⁴⁰⁰ During the parliamentary hearings,⁴⁰¹ Jonathan Spencer of the DTI stated that the role of the DTI is policyholder protection, not investor protection.⁴⁰² Furthermore, some critics of the FSA argue that it has been ineffective in preventing fraud since its enactment.⁴⁰³

389. *Id.*

390. *Id.*

391. *Id.*

392. *Id.*

393. *Id.*

394. *Id.*

395. *Id.*

396. *Id.*

397. *Id.*

398. *Id.*

399. See *No Need to End Self-Regulation*, *supra* note 374 (discussing DTI's spokesman's testimony on Lloyd's continued self-regulation).

400. *Id.*

401. See Hart, *supra* note 12, at 31 (discussing Parliamentary hearings on Lloyd's continued self-regulation).

402. See John Murray, *Lloyd's Passes Solvency Test*, *INDEPENDENT*, Feb. 16, 1995, at 33 (discussing DTI spokesman's testimony at Parliamentary hearings).

403. Creaven, *supra* note 92, at S296.

III. SELF-REGULATION IS ENOUGH REGULATION

The way Lloyd's does business is changing as the role of limited liability corporate capital grows.⁴⁰⁴ Lloyd's, however, will remain a particularly complex and unique trading system.⁴⁰⁵ The level of professional expertise remaining in the market is high, despite the negligent and fraudulent acts of some participants.⁴⁰⁶ Furthermore, the *laissez faire* marketplace that the hands-off leadership of the past decade defended was probably a myth.⁴⁰⁷ The reality of systemic failure of regulation has come to the fore. The fact that failure occurred in the past, however, is not an effective argument against self-regulation in the future. It would be inappropriate to impose statutory changes on the current regulatory system at Lloyd's, as the head of the DTI's insurance division, Jonathan Spencer, recently affirmed in his testimony before Parliament.⁴⁰⁸ Spencer agrees that statutory changes are presently not worth the diversion of time and effort.⁴⁰⁹ Instead, Lloyd's should concentrate on issues of regulatory and commercial substance.⁴¹⁰

A. *The Adoption of Effective Regulation is Process-Driven*

The regulatory failures in the Lloyd's market are being addressed by leaders dedicated to implementing effective changes.⁴¹¹ The economics of the situation demand that changes to the regulatory system be made.⁴¹² Confidence must

404. See *End of the Name*, *supra* note 248, at 107 (discussing role of corporate capital).

405. *Id.*

406. RAPHAEL, *supra* note 1, at 296. "The show ain't over until the fat lady sings." *Id.*

407. *Id.* at 262. "In private, members of the new regime were even more scathing about their predecessors' *laissez-faire* practices." *Id.*

408. See *No Need to End Self-Regulation*, *supra* note 374 (discussing DTI spokesman's testimony at Parliamentary hearings).

409. *Id.*

410. *Id.*

411. See *Time to Complete*, *supra* note 224, at 3 (discussing Lloyd's leaders testimony in Parliament).

412. BUSINESS PLAN, *supra* note 6, at 2. "Our current results are the worst in Lloyd's history. Many members have been brought to the brink of financial ruin, many more are fearful of the future. Confidence in the Society has been shaken. It is now time to take radical action." *Id.*

be restored in order to continue to attract a capital base.⁴¹³ Without a capital base, Lloyd's will cease to do business. In order to restore the needed confidence, Lloyd's must adopt effective regulation.⁴¹⁴

Market forces alone may not be sufficient to ensure prosperity.⁴¹⁵ Some economists believe a form of managed economics is essential to the success of any market.⁴¹⁶ Although this argument acknowledges the need for oversight, it does not imply a need for restrictive governmental regulation.

There are scholars who argue that regulation inhibits the very forces that are favored in a free market and that regulation hinders allocative efficiency.⁴¹⁷ Although there may be policy concerns in a marketplace other than allocative efficiency, such as fairness and the absence of fraud, there is a need for carefully crafted regulation. A conservative regulatory program would impact positively on the smooth functioning of the business of the marketplace.

1. Effective Demand

The process of adopting regulation favors the least-restrictive approach, according to one view that can be applied to the set of facts surrounding the Lloyd's market.⁴¹⁸ There are polit-

413. *Id.* at 2. "Should membership and market not unite behind this plan then Lloyd's may have no future." *Id.*

414. *Id.* at 30. "The Regulatory Board has also developed a new set of regulatory principles that will raise standards further and provide greater protection for the interests of capital providers and policyholders alike." *Id.*

415. See ROBERT L. HEILBRONER, *THE WORLDLY PHILOSOPHERS* 279 (1986) (1953) (discussing views of John Maynard Keynes).

416. *Id.* at 279. "[W]hile Keynes espoused a policy of managing capitalism, he was no opponent of private enterprise." *Id.*

417. STEPHEN BREYER, *REGULATION AND ITS REFORM* 185-86 (1982) (describing virtues of competitive marketplace).

[A] 'least restrictive alternative' approach to regulation . . . would view regulation through a procompetitive lens. It would urge reliance upon an unregulated market in the absence of a significant market defect. In summary form, they include the market's tendency to minimize economic waste by allowing for continuous individual balancing of economic costs and benefits . . . , the carrot-and-stick incentives the market provides for greater efficiency . . . , and the incentives it provides for innovation and the channeling of innovation into socially desirable directions.

Id.

418. *Id.* at 104. "[The regulating body] must choose between the greater control and involvement that detailed regulations imply and the administrative simplicity and greater flexibility of the more general rule." *Id.*

ical economists who argue that the adoption of regulation is to be viewed as taking place in a competitive marketplace of its own.⁴¹⁹ According to this view, the group with the highest effective demand in the marketplace will obtain the most benefits under the system of regulation as adopted.⁴²⁰ This view also posits a small group as likely to be that with the highest effective demand because of the low costs associated with organizing and obtaining information.⁴²¹

In the past, the regulation that existed at Lloyd's consistently favored the small group at the leadership level with the lowest information and organization costs.⁴²² Regulation favored this group at the expense of the others in the market, the Names.⁴²³ The "small group" can be expanded to include the Names and the corporate capital providers. A group comprised of both market professionals and external Names can achieve the highest effective demand. The regulation that is thereafter adopted will naturally favor the entire group.

2. Divergent Interests at Lloyd's

Groups competing to achieve the highest effective demand will be some MPs and loss-making Names who remain unconvinced.⁴²⁴ The difficulty is to align the interests of the Names and the Lloyd's leadership.⁴²⁵ A settlement of Names' litigation claims would promote this alignment.⁴²⁶ For the new settlement proposal to prove effective, it is important that the Names recognize themselves as a group with aligned interests. The fact that

419. Sam Peltzman, *Toward a More General Theory of Regulation*, in CHICAGO STUDIES IN POLITICAL ECONOMY 234-36 (George J. Stigler ed., 1988). "The common role of regulation . . . is as a fulcrum upon which contending interests seek to exercise leverage in their pursuit of wealth." *Id.*

420. *Id.* at 235. "The essential commodity being transacted in the political market is the transfer of wealth . . . [and] the market here, as elsewhere, will distribute more of the good to those whose effective demand is highest." *Id.*

421. *See id.* at 236 (explaining small group dominance).

422. *See Insider Dealing Victims*, *supra* note 25, at 25 (discussing lack of regulation and increased profits for insiders).

423. *Id.*

424. *See Time to Complete*, *supra* note 252, at 3 (discussing Names' complaints regarding regulation and discussing attacks by MPs).

425. *See Doll-Steinberg*, *supra* note 320 (discussing Names' litigation). "The next offer really ought to be the last: the consequences of failure to agree could prove too costly for both sides." *Id.*

426. *Id.*

the suits against Lloyd's actually impact on other Names should be taken into account by them.⁴²⁷ If generosity of spirit is not enough to convince them of their dependence on one another, the limited funds of the Errors and Omissions underwriters should. Without a settlement, some Names may get nothing if they are not the first to win awards in court.⁴²⁸

A further effort towards achieving unity between the working and external members of Lloyd's would be to publish a regulatory framework that includes some of the stated goals of the Lloyd's Names Association Working Party, like sanction power and victim compensation.⁴²⁹ The situation at Lloyd's changes frequently. A working document rather than a set of policy goals, however, would impress upon those Names and incorporated members, with whom the Lloyd's leadership needs to align itself, that the leadership is serious about reform. Any such document would be subject to revision and amendment, but it would be an implementation, rather than a statement of policy.

B. *The Changes Necessary to Restore Confidence in Lloyd's*

The primary policy goal of the Lloyd's Regulatory Board is to create more transparency in the way the marketplace does business.⁴³⁰ Already, greater disclosure requirements have been implemented.⁴³¹ There has been a re-emphasis of agents' duties to Names.⁴³² There are many other changes which need to be made.

1. Names' Rights and the Duty of Care

Names must have the right to examine information that they find pertinent to the decision to join or resign from a particular syndicate. The strict duty to disclose must extend beyond quarterly reports and similar periodic forms of disclosure. Names must have rights to information similar to those provided

427. See BUSINESS PLAN, *supra* note 6, at 29 (explaining assets being sought through litigation belong to other Names).

428. See Helen R. MacLeod, *U.K. Court Places Burden of Old Claims on Lloyd's Investors*, J. OF COM., Feb. 13, 1995, available in LEXIS, News Library, US File (explaining E&O coverage not enough for all Names).

429. See Bagnall, *supra* note 258 (describing goals of LNAWP).

430. See BUSINESS PLAN, *supra* note 6, at 31 (listing goals of new regulatory regime).

431. See *id.* (detailing stricter disclosure requirements).

432. *Id.*

to shareholders of a public corporation in the United States.⁴³³ Similarly, those rights should be qualified. Market professionals must be not be subjected to harassment.

Because of the duty of care that the courts held is owed to the Names by managing and members' agents,⁴³⁴ broad disclosure rules make business sense as well. Each agent should provide an investor relations office to the keep the capital providers informed. The central market already provides reports on global syndicate financial results,⁴³⁵ but there could also be a central office to handle inquiries.

2. Changing Standards

The admission of Names to the Society must be closely monitored. Financial requirements are again becoming more stringent.⁴³⁶ While the problem of Names leaving the market is currently more pressing than that of new Names entering,⁴³⁷ if more capital is to be sought under the current system, this issue must be addressed further. It is sensible to determine what form the market will take in the future before devoting a great deal of energy to substantive change in this area.

The unlimited liability of Names must be eliminated entirely. While investors in a corporation give up their control rights in exchange for limited liability,⁴³⁸ Names give up control and still accept unlimited liability.⁴³⁹ This arrangement no longer makes commercial sense. It would be a gesture of good faith to lessen the burden placed on Names by adherence to the doctrine of *caveat emptor*. To do so would emphasize Lloyd's recognition of its regulatory duty to protect Names. Any new Name seeking to join Lloyd's should be required to join as part of a limited liability arrangement.

433. SOLOMON ET AL., CORPORATIONS LAW AND POLICY 830 (1994) [hereinafter CORPORATIONS].

434. *Deeny v. Gooda Walker Ltd.*, 1994 P.12 (Eng. Q.B.) (Oct. 4).

435. See LLOYD'S OF LONDON GLOBAL RESULTS 10 (1993) (stating global syndicate results).

436. See RAPHAEL, *supra* note 1, at 49 (stating minimum financial requirement is now UK£250,000).

437. See Dacey, *supra* note 46, at 1 (stating current membership).

438. See CORPORATIONS, *supra* note 433, at 1 (sketching features of corporation).

439. See RAPHAEL, *supra* note 1, at 48 (discussing Names' acceptance of unlimited liability).

Professional standards for working underwriters⁴⁴⁰ must be made stricter. Licensing procedures could be implemented that mirror those of the State Insurance Commissions⁴⁴¹ in the United States. Qualification programs are being implemented,⁴⁴² but incentive programs need to be in place as well. Compensation of the working underwriters must be tied in part to profitability.

While many agree that the incorporated capital vehicles will make transparency and disclosure commonplace,⁴⁴³ there must be disclosure with respect to these vehicles as well. The leadership has expressed its commitment to the underwriting Names who remain at Lloyd's, assuring them that their interests will not be sacrificed in favor of the incorporated vehicles.⁴⁴⁴ The incorporated vehicles should be required to disclose financial information and analysts' reports to the Names with whom they share syndicates. Names will then have an advantage in deciding whether to remain as members of a particular syndicate.

There must be stronger reserve requirements. Jonathan Spencer of the DTI called for stronger reserve requirements for European Union-based insurers as part of tougher solvency requirements for those European Union insurers that face uncertainty about their liabilities.⁴⁴⁵ Any reforms should be extended to Lloyd's.

There must be an end to open-years. If the Equitas project is successful in reinsuring the market's run-off risks, the reinsurance-to-close system should be replaced as soon as possible. Names should be allowed to resign at the end of each year, if they so choose.

The key to effective self-regulation, as the Lloyd's leadership

440. See BUSINESS PLAN PROGRESS REPORT 21 (May 1994) [hereinafter PROGRESS REPORT] (describing commitment to improved standards of professionalism in market).

441. See, e.g., N.Y. INS. LAW § 20.1-20.2 (McKinney 1994) (discussing theory and functions of New York State Insurance Department).

442. See PROGRESS REPORT, *supra* note 440, at 21 (describing standards of professionalism).

443. See *End of the Name*, *supra* note 248 (discussing effect of corporate capital).

444. See PROGRESS REPORT, *supra* note 440, at 7 (describing benefits to all of admission of corporate capital).

445. See Ralph Atkins, *DTI Calls For Action on Insurer Insolvency*, FIN. TIMES, Feb. 16, 1995, at 8 (discussing DTI proposals regarding solvency of European Union insurers).

has argued,⁴⁴⁶ is to create a regulatory system with real independence.⁴⁴⁷ Such a system can be created under the current statutory regime,⁴⁴⁸ if the leaders and the membership of Lloyd's recognize their common interest. Recognizing this common interest will allow them to reach the common goal of continuing success for Lloyd's, which will benefit all parties.

CONCLUSION

Lloyd's fought against outside regulation for reasons beyond the self-interest that has characterized much of its dealings in the last decade. Lloyd's has been a practicing marketplace for over three hundred years. Those in the marketplace are uniquely suited to oversee their own affairs. If Lloyd's survives, all the capital providers in the market may eventually be limited liability incorporated vehicles, leading to greater transparency in the market. Without unlimited liability, Lloyd's will rely on efficiency and expertise to give it a competitive edge. Effective self-regulation will foster the competitive virtues of the Lloyd's market. This solution will restore confidence in the market, which is critical to the survival of Lloyd's.

446. See BUSINESS PLAN, *supra* note 6, at 30 (describing plans for new regulatory regime).

447. *Id.*

448. *Id.*