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SPECIAL ISSUE ON LLOYD'S

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AN INTRODUCTORY NOTE FROM THE EDITOR

Richard E. Stewart is chairman of Stewart Economics, Inc., a consulting firm specializing in insurance. Previously he was New York superintendent of insurance, president of the National Association of Insurance Commissioners, general counsel of Citibank, and chief financial officer of the Chubb Group of Insurance Companies.

I have known and respected Mr. Stewart for more than forty years. We first became acquainted shortly after he was appointed superintendent of insurance of New York in 1967 by Nelson A. Rockefeller, who at the time was the governor of New York.

Steven E. Sigalow is a partner at Jones Day, an international law firm. He is co-leader of the firm's insurance liability and recovery practice. The views expressed in the article that begins below are his personal views and do not necessarily reflect the views of the law firm.

Mr. Stewart recently shared with me an article that he and Mr. Sigalow had written about the serious financial problems faced by Lloyd's in recent years. The article is important, in my opinion, for reasons discussed in the editor's postscript on page 16. The authors approved my editing of their article.

HOW LLOYD'S SAVED ITSELF

by Richard E. Stewart and Steven E. Sigalow

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At the Lloyd's city dinner on September 17, 2009, the chairman of Lloyd's, Baron Levene of Portsoken KBE, warned the leaders of London's financial center against political overreaction to irresponsible behavior in the banking industry. Lord Levene then turned to Lloyd's itself because

...there are things to be learned from our experiences. Some twenty years ago, largely because of our own follies, we had our own "near-death" experience. We found salvation partly by off-loading toxic liabilities into a separate vehicle, Equitas—a mechanism we are now seeing repeated with banks around the world—but also, and most importantly, by embarking on a period of profound change.¹

Lord Levene suggests we can learn from the Lloyd's experience. To do so, however, we need to know about it in some detail.

A Description of Lloyd's

The events described here took place at and around Lloyd's in the period from the end of World War II to the present. During most of that time, Lloyd's was one of the largest property-liability insurance organizations in the world and the largest and most important one for reinsurance.

Lloyd's was not an insurance company. It was a place, with rules and governance, where others traded in insurance. Its key participants were Brokers,

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Underwriting Agents, and Names. Brokers brought in the customers—people and businesses seeking insurance and insurers seeking reinsurance. Underwriting Agents decided whether to insure or reinsure and, if so, on what terms and at what prices. Underwriting Agents and Brokers made all the business decisions at Lloyd's. They were the people who made the rules and performed the governance of Lloyd's.

Names supplied the capital, not in funds but in the form of contingent, unlimited, personal liability. At that time, only individuals could be Names and, during most of the period, only male subjects of the United Kingdom could be Names. The U.K.'s upper social, economic, and political classes were, and for centuries had been, heavily represented among the Names.

Two Distinguishing Features of Lloyd's

Lloyd's had two features that were part of its charm—its unusual form of organization and the unlimited liability of the Names. Lloyd's had a late medieval legal form, where capital was passive, personal, and separated from management. At the time Lloyd's was started in the late 17th century, the business corporation had not yet been invented.

Later, Lloyd's stayed with the old form for its tax-sheltering effect and for its ability to monetize land. Great estates, which were illiquid assets, could serve as collateral for Lloyd's memberships, which paid cash. The leaders of Lloyd's resisted direct suggestions—from the New York superintendent of insurance, among others—that it change to a modern corporate form, with the Names as limited-liability investors, either entirely or for its American business.

There were two consequences of the unlimited liability of such prominent Names. One was that Lloyd's could not, even as a last resort, abandon its Names the way a distressed business corporation, or its receiver, could abandon its shareholders.

A second consequence was the allocation of control, risk, and reward. At Lloyd's, total control was in the hands of Underwriting Agents and Brokers. They were compensated by commission. That meant the Names bore the risk of bad overall results in an unusually severe way (unlimited personal liability), while the people with all the decision-making power were compensated on premium volume alone, uninfluenced by overall results, that is, without regard to loss on the business they brought in.

That arrangement is familiar in insurance with managing general agencies, which can only succeed for both parties with great trust and self-restraint. MGA arrangements tend to blow up if the agent pursues his own self-interest, that is, goes for volume regardless of quality.

That same lesson has now become painfully familiar in banking. The subprime mortgage-backed securities that broke the investment banks and other famous

financial institutions were put together and sold by bankers compensated by commission, with the overall risk passed on to others. What broke the banks were the portions of their deals that they chose to retain for themselves.

How Lloyd's Set Itself Up for Disaster

The recovery after World War II generated a huge demand for insurance. At the time, Lloyd's had about 2,500 Names. They could not begin to handle the new business the Brokers and Underwriting Agents could generate. More business would mean more premiums, which would mean more commissions.

Much of the new business would come from the U.S., where the big property-liability insurers were already revising their principal commercial liability policy forms to respond to the contemporary concerns of business (mainly injury over time and injury from mass-produced products) better than any of the world's other insurers.

So Lloyd's lacked both the financial capacity to handle the new business and the appropriate product to attract it. Lloyd's responded in two ways.

First, it expanded its membership. Previously excluded groups, such as Americans and women, were allowed to become Names. Members' Agents, subsidiaries of Brokers and Underwriting Agents who were accustomed to receiving pleas to become Names, fanned out to recruit them. They succeeded, and the number of Names doubled in twenty years and tripled in the next twenty. In the process, Lloyd's admitted to its club additional Underwriting Agents, some of whom were not schooled in the club's tradi-

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tion of self-restraint and, hence, might be expected to act like managing general agents pursuing their own self-interest.

Second, it broadened its principal liability policy form. Lloyd's unofficially introduced a broker's form of first-excess-layer liability insurance called the umbrella. It was muddled, but used several appealing words and was promoted as being unbelievably broad. The Brokers marketed it aggressively, and the Underwriting Agents priced it low and wrote it above self-insured retentions so small that it was the functional equivalent of primary coverage (which Lloyd's could not write in the regular U.S. market). The Lloyd's establishment resisted the umbrella at first, but then gave in. Later, some worried Underwriting Agents started to tighten up the form, but then they gave in too.

After those two changes, as before, all the business decisions at Lloyd's were made by people compensated by commission. They did not bear any of the risk of overall profit and loss.

Early Warnings

In the mid-1970s, Lloyd's was the victim of insurance scams involving unnecessarily repeated reinsurance transactions, leaving the last underwriter holding the bag for a lot of risk with little premium. The best known cases were the Sasse Syndicate and the LMX Spiral. The perpetrators got commissions. Some of the perpetrators of the Sasse scam were Americans whose insurance licenses had been revoked long before in the more regulated U.S. market. In the LMX Spiral, the perpetrators were Lloyd's Brokers themselves, passing reinsurance around and collecting commissions at each step.

The early warnings showed the expanded, more openly commercial, less clubby and cohesive Lloyd's could be penetrated by convicted felons (Sasse), that Brokers would abuse Underwriting Agents and Names for profit (Sasse and LMX Spiral), and that Underwriting Agents would abuse Names for profit (LMX Spiral and several others). The umbrella itself amounted to the abuse of Names through the joint efforts of Brokers and Underwriting Agents. While the Brokers and Underwriting Agents who made all those decisions were compensated by commission, the Names took the losses.

True Disasters Arrive

Lloyd's could contain, cover up, clean up, and provide for the early troublesome episodes with relatively minor reforms. The next wave of problems was too big to be contained.

For decades, asbestos had been everyone's favorite construction insulation. Over the years medical evidence built up that asbestos could cause terrible lung diseases that emerged decades after inhalation. After 1973, groups of former construction workers became

eligible to sue not just the building contractors that employed them but also the richer asbestos producers and insulation manufacturers.

Asbestos was a catastrophe—the liability equivalent of an earthquake. All general liability insurers, including Lloyd's, fought coverage tooth and nail. After years of litigation, by and large they lost.

Environmental pollution was a known byproduct of industrialization. It was a manageable problem for industrial corporations and their insurers, including Lloyd's, as long as suits depended on proving negligence and suits were brought one at a time. Then, in the late 1960s, the situation changed dramatically. Class actions began and insurers got scared.

In 1970, the U.S. and U.K. insurance industries adopted a partial pollution exclusion so unclear that, to this day, nobody really knows what it means. Courts are evenly divided when they are compelled to interpret it.

Then, in 1980, Congress fell for the meretricious “polluter pays” idea and enacted strict liability, or the old law of nuisance, for everybody in any way connected to a pollution situation. That set off a frenzy of cost shifting, in which some 88 cents of every dollar spent for “cleanup” went for lawyers, consultants, and other transaction costs. To insurers worldwide, the environmental liability catastrophe looked even worse than the asbestos catastrophe. They dug in again but, after decades of litigation, by and large they lost that one too.

Consequences for Lloyd's

Those two liability catastrophes, plus another for medical products, cost commercial and industrial liability insurance companies—particularly the twenty or so largest ones—a ton of money. But none of the large companies was bankrupted by them. The long coverage fights separated the individual hits and spread them over time, during which investment income built up a cushion against them. Some companies “restructured” themselves by putting large claims in runoff vehicles and then cutting them loose.

For Lloyd's it was another matter. The wide-open, broker-drafted umbrella was all over the American market, and the Underwriting Agents had also written large amounts of excess coverage following the umbrella form.

An insurance company is a corporation and has a perpetual life. It can carry an unresolved claim on its books as a reserve liability forever if necessary. Lloyd's risk-bearers were not corporations. They were people, the Names. Sensible people would want to end their exposure sometime and get their money out.

So several centuries ago, Lloyd's adopted the practice of closing years of account three years after the underwriting year ended. Then any unresolved claims (and, in the era of fire and marine insurance, there were few) would be reinsured by a successor syndi-

cate for a premium agreed between the two Underwriting Agents (who were often the same person). It was brilliant and it worked. It all depended on being able to determine a price for the reinsurance to close.

For hundreds of years, Lloyd's wrote only marine insurance. Losses were known quickly, coverage was effectively all risk, and the value of a total loss had been agreed upon in advance. Claims were settled fast, and three years were more than enough to settle everything or get a clear idea of the premium needed for the modest reinsurance to close. In the 19th century, Lloyd's added some fire insurance, which also had prompt claims resolution.

Then in the early 20th century Lloyd's got into liability insurance, where many claims were not resolved quickly and where estimating the value of open claims, and hence the premium for the reinsurance to close, was more difficult. With asbestos, pollution, and medical liability, it became just about impossible.

So the old underwriting years remained open and exposed to claims that could be carried back under the wide-open umbrella policy. How far could they be carried back? Ten, twenty, fifty years were not out of the question, keeping in mind that those old years had been closed (reinsured) forward over and over again.

To make matters worse, reinsurance to close, like all reinsurance, did not get the ceding insurer (Name) entirely off the hook. It just meant that the paying/ceding Name could turn to the reinsurer (the later syndicate's Names) for reimbursement. So reinsurance to close would not really have solved the problem at Lloyd's. It would just have shifted the problem from one group that Lloyd's did not want to go after to another group that Lloyd's did not want to go after.

For similar reasons the American "restructurings" that were taking place at the same time with the same purpose—getting rid of large claims—would not have worked at Lloyd's. Names lived on and reinsurance to close exposed year after year. It was an uncelebrated I-told-you-so moment for all those who had urged Lloyd's to put its syndicates into corporate form and then to close off policy years in the conventional way.

The Initial Response of the Names

The problem was bad and getting worse. In 1980, there were 32 syndicate years of account unable to close. By 1990, there were 97.² Names left on open years were already receiving demands for cash. Lloyd's and its Underwriting Agents had set aside no capital or reserves for such a rainy day, so the Names were exposed immediately. But collecting from the Queen, Pink Floyd, and numerous nobles, celebrities, scions of vast acreage, and captains of industry, not to mention Names in later years (many of them newly inducted Americans) who suspected they had been set up, was not an attractive prospect.

Names sued for fraud and mismanagement instead of paying what the Underwriting Agents said they owed. Names sued their Underwriting Agents and members' Agents, their Brokers, auditors, and anyone else they could find. Few of the defendants had large assets, so the real targets were their professional indemnity insurers. Since most of their policies had been placed in the Lloyd's market, this meant one Name was suing another.

Lloyd's, as an institution, needed a way to get all of its Names and itself entirely off the hook. Otherwise, its leaders believed that it did not have a chance to survive.

How Lloyd's Saved Itself—The Original Equitas Plan

By the early 1990s, Lloyd's was a cauldron of recrimination. Claims that underwriters had never expected to materialize at all were coming in with the morning mail. The Names were on the hook and, given what important people they were, Lloyd's logically wanted to protect them.

So the goal at Lloyd's was "finality," which meant to end the liability of the Names for the open-year claims. Lloyd's needed a plan that not only would achieve finality, but would do so in a socially and commercially acceptable way in the circles that mattered to them, that is, the upper economic, political, and social classes of England.

The Lloyd's business plan was called "Reconstruction & Renewal" ("R&R"). It called for Lloyd's to split its book of business into two parts—the old, open years and the new years. The old years were the 1992 and prior open years. They were to be put into a runoff company. The existing and renewal business, from 1993 forward, was to be kept in a "New Lloyd's." New Lloyd's was intended to survive and be profitable in the future. Without the burden of the open years with unpaid claims, it ultimately was profitable.

But the more interesting story is about those unpaid open-year claims, the ones from which Lloyd's walked away. These claims were sent to a new company named Equitas to be run off.

To free up Equitas to deal with policyholders in ways most favorable to the Names, Lloyd's needed to keep Equitas at a safe distance from two spheres of influence that offered policyholders some protection. One was U.S. law and regulation. Once convinced that an insurer was deliberately abusing policyholders or playing games with the courts, U.S. courts would sometimes impose punitive damages—sometimes in amounts large enough to hurt and to attract bad publicity. U.S. insurance regulators had wide discretionary powers and, even more worrisome, statutes dealing specifically with unfair claims practices.

The other influence Equitas needed to avoid was that of the market. Lloyd's intended to resume its

leading place in the world of insurance. Lloyd's had a valuable reputation and wanted to protect it. Giving the ongoing Lloyd's a reputation for ferocious denial of claims would make it hard to sell policies.

Lloyd's tried to address both needs. Equitas was closed for new and renewal business, so it was not in the market. Equitas did its best to get beyond the oversight of U.S. insurance regulators and courts, both as to its financial condition and as to its claims handling conduct. Claims denial includes coverage denial. In all cases, the policyholder's claim on the insurer is being denied.

Lloyd's accomplished all this with regard to claims that were overwhelmingly in the U.S. and involved injured American people and property. Lloyd's accomplished it while keeping control of those claims in Equitas and while keeping Lloyd's eligible to write insurance in the U.S. market. It was no mean feat.

At this point, Lloyd's looked to have achieved both of its goals for Equitas—no U.S. law or regulation and no spillover onto the market reputation of Lloyd's. One would think that Lloyd's had done everything it could to protect the Names. But the Names did not think so.

How Lloyd's Saved Itself—The Final Equitas Plan

Any visible tie between Equitas and Lloyd's would restrict the activities of the one and sully the reputation of the other, and one tie remained. Lloyd's was to own Equitas. Lloyd's original business plan of April 1993 provided that Lloyd's would own and control Equitas, including its handling of claims.

Ownership of Equitas by Lloyd's would also have allowed Lloyd's to supplement the surplus of Equitas, and so would have allowed policyholders (or regulators) to demand it. The reinsured Names did not want any of that. They wanted to be far away from Equitas' handling of claims and far away from any calls for money.

Throughout the R&R process, Names expressed fear that the "claims culture" of Lloyd's would be perpetuated in Equitas and that claims would be settled with the interest of the ongoing market in mind, rather than in the interests of the Names.³ Slaughter and May, a large, famous, and respected London law firm serving as independent legal advisers to the Names, acknowledged that this was an understandable fear:

[M]ost Names accept that, as long as Lloyd's is a going concern, it is a proper exercise of the counsel's powers to ensure that policyholders are adequately protected, in order to protect the credibility of the Market. The interests of ongoing Names and policyholders tend to coincide in that situation.⁴

Counsel thus confirmed that Lloyd's, as an ongoing market participant with reputational constraints, had incentives to deal fairly with policyholders. So Lloyd's decided that Equitas would not be a partici-

pant in the ongoing Lloyd's market. Lloyd's gave up, in the final plan, any ownership or control of Equitas. The Names did not have to worry that the continuing business of Lloyd's would cramp Equitas' style.

Instead Equitas was owned by a trust required "to have regard to the interests of Names reinsured into Equitas."⁵ Slaughter and May opined that under the new structure the directors and management of Equitas would be responsible to Equitas, the Names, employees, and (in certain circumstances) creditors, but to no one else.⁶

The new structure achieved the objective of Lloyd's and the Names to have the pre-1993 claims reinsured and then run off by a separate company that was subject neither to self-regulation by Lloyd's nor to regulation by the American courts or commissioners.

This was the way Lloyd's sought to protect its Names. Lloyd's achieved it through an unwavering focus on the interests of the Names. The solution was designed single-mindedly to serve the interests of the suppliers of capital—the shareholders had Lloyd's been a corporation. Throughout the discussions and in the documents, it is hard to find a single mention of policyholders, even their existence, let alone their interests or any obligation to them.

Saving the Names with Policyholder Money

Equitas had two overriding objectives that governed its business strategy: (1) to shield Names from their liability on old policies or, as Lloyd's put it, to bring "finality" to the exposure of the Names, and (2) to return to the Names some of the reinsurance premium that funded Equitas.⁷ Those objectives could only be achieved by making Equitas' reserves last beyond the life of the claims.

In furtherance of that objective, Equitas took several steps that would have been impossible for an ongoing insurer. It set loss reserves low, then discounted them to present value, and then rewarded adjusters for settling under that number. It not only publicly referred to its own precarious financial condition, but used it as a tool to exact below-reserve settlements.⁸

Agreements to cancel insuring contracts and buy immunity from future liabilities ("policy buy-backs") were voluntary transactions, and Equitas stated that it would not enter into them unless the amount paid in settlement reflected Equitas' valuation of the exposure, appropriately discounted.⁹ Thus, for settlement purposes, Equitas started with a doubly discounted value. You do not believe it? Start with the way every other insurance company is supposed to set reserves (ultimate value, not discounted for anything). Then discount it for the time value of money. Then discount it again for the value of avoiding litigation. Then start negotiating (down).¹⁰

Equitas' management measured "winning" and "losing" by whether a settlement or policy buy-back

beat the discounted balance sheet value (single discount). According to management, they were winning.¹¹ Indeed they were. As shown in the chart below, policy buy-backs for less than reserved amounts added to Equitas' surplus, including as much as 45 percent of that surplus in 2001.

Equitas' rationale for bargaining down claims was set out in a speech made before the Insurance Institute of London in January 1999 by Equitas' claims director, Scott Moser.¹² Mr. Moser gave the same analysis to the reinsured Names in September 2000.¹³ Mr. Moser said the time value of money was worth more to the policyholder than it was to Equitas because the policyholder could earn a higher return on its business than Equitas could earn on its investments. If a litigated claim were expected to take years to resolve, then a settlement today should consider the difference between the present value of the claim for the policyholder and the present value of the claim for Equitas. Mr. Moser concluded that it was fair to split the difference.

Lloyd's and its Names set up Equitas so that its claims handling practices would be subject to neither the reputational constraints of Lloyd's nor the interests of an ongoing business. It was also set up so that its claims handling practices would not be subject to the laws and regulations of the country where most of the policies had been written. Mr. Moser's bizarre theory of claim valuation is one illustration of why.

For his efforts with claims, Mr. Moser was promoted to president and chief executive officer of

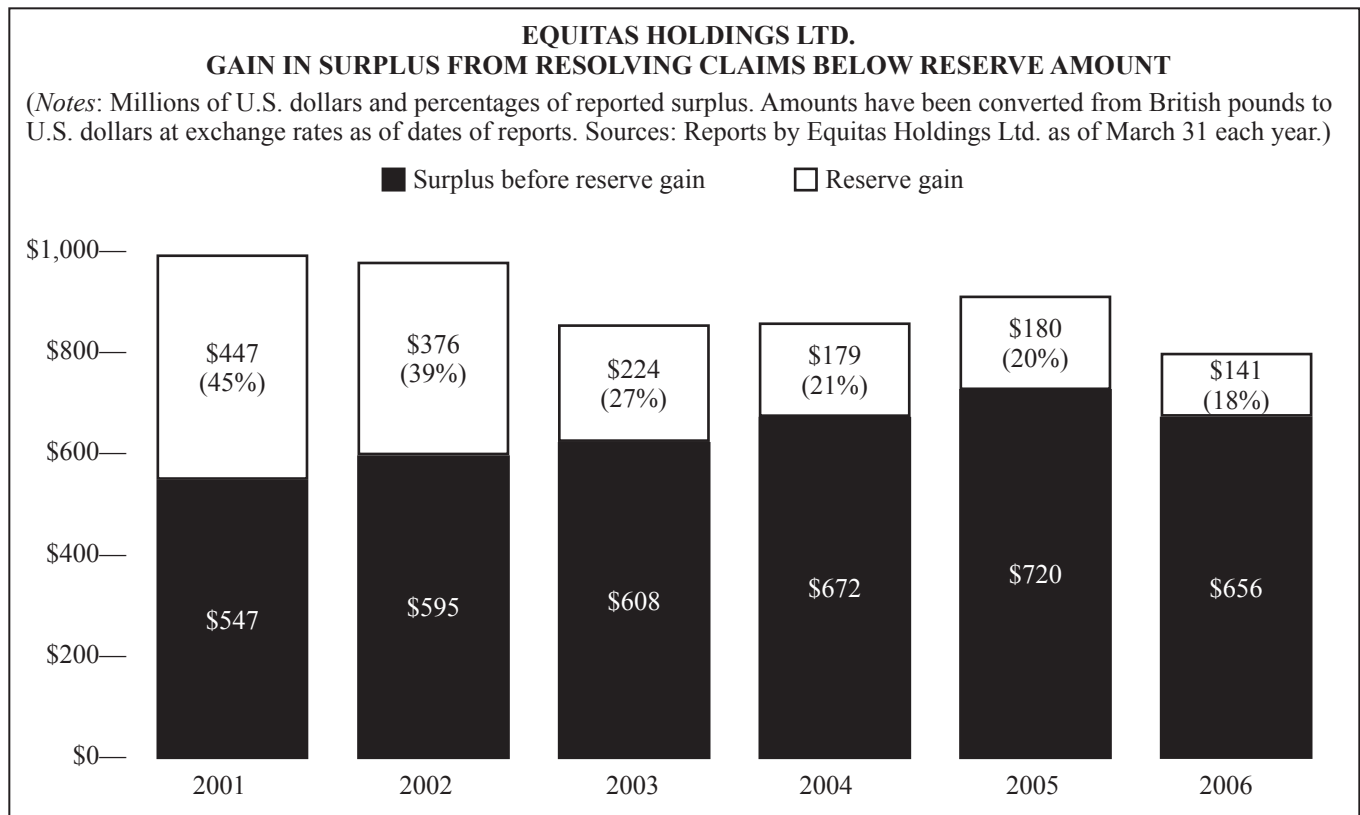
Equitas and rewarded with bonuses totaling more than \$6 million. The rest of Equitas' top management had personal incentives as well. Equitas stated that the careers of its executive directors in the insurance industry would have been seriously compromised by an Equitas failure.¹⁴ But this failure was avoided by Equitas' pursuit of the same strategy that spared the Names.

A positive management incentive was contingent compensation. Settling claims and buying out policies for less than their reserved amounts added to surplus, the only fund from which bonuses could be paid. In 2007 alone, Equitas' executive directors were awarded bonuses of \$50 million. That was \$50 million contingent on not paying claims, in whole or in part.

Was Equitas Solvent?

Lloyd's paid to Equitas a single premium that was the equivalent of the premium for traditional reinsurance to close. There was to be no additional premium. This initial premium was the only money Equitas started with to get through all its claims. Thereafter all Equitas could add was modest investment income and the much larger amounts it could gain by resolving claims for less than the amounts for which they were reserved.

No one knew at Equitas' creation or later whether Equitas was adequately funded, and Equitas' management made a point of saying so at every opportunity. Its chairman stated that Equitas began as a company



with a high risk of failure.¹⁵ That fact was useful in scaring policyholders into cheap buyouts, and Equitas kept repeating it. If Equitas were to need more money, it certainly was not going to get it from the Names.

Equitas did not publish financial information with anything like the detail required of U.S. insurance companies. It used accounting conventions far more permissive than those allowed for American companies. By U.S. accounting standards, Equitas was bankrupt from opening day.

The effect of all the lax accounting was to keep Equitas looking solvent so it could keep going and keep doing what it was designed to do. No agency—U.K. or U.S., state or federal—wanted to close it, which was quite a demonstration of the way regulation works when the chips are really and truly down. This is a good cautionary tale for a Congress and President tempted to see prudential regulation as the sole answer to irresponsibility, avarice, and madness in finance.

Confirmation from a Highly Qualified Source

Warren Buffett is the most successful, most admired, and richest investor in the world. Having begun with U.S. common stocks, he now invests in many kinds of assets in many countries. His holding company, Berkshire Hathaway Inc., mainly owns insurance companies that generate cash for him to invest. Its principal subsidiary for commercial insurance is National Indemnity Company.

In October 2006, Equitas announced a transaction with National Indemnity. In phase one of the transaction, National Indemnity reinsured all of Equitas' reinsurance obligations and provided an additional \$5.7 billion of reinsurance over Equitas' reserves. In phase two, which closed in 2009, National Indemnity, Lloyd's, and the Names successfully obtained U.K. high court approval of the transfer of the Lloyd's policies to National Indemnity.

Phase two ended the liability of the Names (achieving the finality they always sought) and substituted National Indemnity as the security on the policies. As part of phase one of the transaction, National Indemnity also took over the staff and operations of Equitas and assured everybody that the runoff was "to be managed in London by essentially the same people and in essentially the same way as [in 2006]."¹⁶

For their part, Equitas executives got bonuses of \$30 million after the closing of phase one of the deal. For his part, the astute Mr. Buffett got two things of great value to an investor like him: cash to invest—he got \$7 billion of Equitas' cash reserves—and the best protection available against efforts by policyholders to take that cash away—the Equitas claims-denying machine.

Good and Bad Faith in Claims Handling

Insurance is an unusual business in that the cus-

tomers pay (the premium) for the product (payment for a loss) long before the product is delivered. During the interval between sale and claim, two things can go wrong. The insurer can go broke and thus become unable to pay. Or the insurer can decide to keep the money and become unwilling to pay.

Regulators and courts devote a lot of attention to dealing with these two ways insurance can go wrong. Unwillingness to pay, and the tactics used in pursuit of it, are called bad faith claims handling. Almost every state has a statute, first developed by one of the authors, prohibiting bad faith claims handling and spelling out specific actions that are evidence of it. The statutes are aimed at patterns of conduct rather than single incidents. The courts impose punitive damages in individual cases for egregious examples of bad faith claims handling.

A good working definition of bad faith, and one often used by courts and regulators, is putting the interests of the insurer ahead of the interests of the policyholder. But what about never thinking about the interests of the policyholder at all? The Names and Underwriting Agents (the equivalent of the insurance company) created Equitas for the express purpose of putting their interests ahead of the interests of the policyholders; indeed, they appear to have created Equitas so as to exclude the interests of policyholders. Then they gave underwriting years with open claims to Equitas to do what Equitas was created to do.

Conclusion

If one steps back to gain perspective, the story of how Lloyd's got into trouble and then got out of it is a simple one. It can be told using Lloyd's public documents, which is what we have tried to do here.

Lloyd's got in trouble because its decisions were made by people paid according to the amount, not the quality, of the business they did, that is, for the volume of premium they took on for the Names. That worked until the decades of economic growth after World War II led Lloyd's to expand rapidly. Its club-like culture of honor and self-restraint could not withstand the pressure for premium volume.

So Lloyd's plunged ahead unrestrained, until it blew up. The blowup exposed the Names to ruin. It put Lloyd's at the brink of extinction.

How Lloyd's saved itself brings us back to Lord Levene, the chairman of Lloyd's, whom we quoted at the beginning of this article as stating that the steps Lloyd's took to save itself have now been repeated by banks in the current financial crisis. We can now see that the analogy is false.

Both Lloyd's and the major banks took in money under contract obligations to pay as directed in the contract. Both institutions came up short, that is, they could not meet their contract obligations.

The contract obligations of the banks themselves have been met, often with immense help from govern-

ments, and many such obligations of nonbank holding companies and affiliates have been met as well. Shareholders of banks and bank holding companies—their investors—have been severely penalized or wiped out entirely.

By contrast, Lloyd's saved its investors—the Names. It did so by creating a special legal vehicle—Equitas—to deal with its contract obligations. Lloyd's

was careful to place that vehicle under no legal obligation to consider the interests of the other parties to those contract obligations. So Lloyd's saved itself and its investors by avoiding its contract obligations.

That is the opposite of what was done with the banks. Imagine what would have happened to the world financial system if just one of the big banks had done what Lloyd's did.

NOTES

1. *Insurance Research Letter* (September 20, 2009).
2. Lloyd's of London, *Lloyd's: a route forward* (January 1992), p. 107.
3. Slaughter and May, *Report to the Committee Known as the Lloyd's Settlement Validation Steering Group* (April 2, 1996), p. 20.
4. *Ibid.*, p. 24.
5. Lloyd's of London, *Settlement Offer* (July 1996), p. 81.
6. Slaughter & May, *supra* note 2, p. 20.
7. Equitas Reports & Accounts (March 31, 1998), p. 6.
8. Equitas Open Meeting of Reinsured Names (September 10, 2004), pp. 16-17, 19.
9. *Ibid.*, p. 8.
10. *Ibid.*
11. *Ibid.*, p. 32.
12. Scott Moser, *Equitas Claims*, Address to the Insurance Institute of London (January 14, 1999).
13. Scott Moser, Remarks at Equitas Open Meeting of Reinsured Names (September 8, 2000), p. 8.
14. Hugh Stevenson, Chairman of Equitas, Letter to Reinsured Names (December 12, 2006).
15. *Ibid.*
16. *Ibid.*

EDITOR'S POSTSCRIPT

The Stewart-Sigalow article is important for the insurance world generally and because of its detailed discussion of Lloyd's. It is also important because it is reminiscent of three other developments that are discussed in this editor's postscript.

The Separation Technique

For more than ten years, Consecro, Inc. needed to infuse large amounts of capital into Consecro Senior Health Insurance Company (CSHI), a financially troubled long-term care insurance subsidiary. In 2003, CSHI stopped selling new policies and went into runoff. In 2008, Consecro transferred CSHI to an independent trust and changed the name of the company to eliminate the reference to Consecro. The Pennsylvania insurance department approved the transfer without a public hearing. Also, the department refused to make public an important document—an actuarial report prepared for the department analyzing CSHI's financial condition. Articles about the transfer are in our November 2008, January 2009, and June 2009 issues.

Tough Claims Handling

Unum Group has been trying for 17 years to deal with losses in its "old block" of noncancellable and guaranteed renewable disability insurance policies. The policies apparently were underpriced and were heavily sold to professionals—especially physicians.

Unum's efforts to deal with the problems have involved to some extent the creative use of reinsurance. From the viewpoint of policyholders, however, it is more important to recognize that tough claims handling practices have resulted in thousands of individual lawsuits by angry policyholders whose benefits were either initially denied or initially honored and later terminated. Unum's claims practices have produced a large amount of adverse publicity for the firm, including segments on *60 Minutes* and *Dateline NBC*. I have discussed Unum's claims practices in several articles. For example, see our February 2003, February/March 2005, April 2005, January 2006, February/March 2006, and March 2009 issues.

Takeover by Marketers

The Stewart-Sigalow article is also reminiscent of an extraordinary 76-page 1990 Congressional staff report entitled *Failed Promises: Insurance Company Insolvencies*. The report is the product of a study undertaken in the wake of the savings and loan debacle of the 1980s. The report was prepared by the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce of the U.S. House of Representatives. The report discusses, among numerous topics, the adverse consequences of allowing managing general agents to take over the underwriting and pricing of insurance business.