**Delusions of competence: the near-death of Lloyd’s of London 1980-2002**

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**Introduction**

Rapid structural change resulting from system collapse is a less common phenomenon in insurance than it has been in the history of other financial institutions, such as banks and stock markets, where the flows of capital and credit act as highly visible metrics of market confidence and volatility. Catastrophic losses, of course, have delivered great shocks to the global insurance industry. The San Francisco earthquake of 1906, for instance, led to an influx of European reinsurance capacity into the US and the exit of weaker American and foreign direct insurers. In this and other similar cases, however, such catastrophes largely resulted in the rearrangement of players on the field, rather than a fundamental change in market structures or underwriting practices.[[1]](#endnote-1)

One exception to this general pattern was the crisis that afflicted one of the world’s oldest insurance markets, Lloyd’s of London, in the late twentieth century. Hitherto, explanations of the crisis have focused on catastrophic losses and problems of internal governance.[[2]](#endnote-2) This paper argues that these factors, while important, may not have resulted in institutional collapse had the actors involved not also suffered from multiple delusions of competence. Arrogance, elitism, greed, corruption, and stubborn resistance to reform in defence of vested interests comprised endogenous elements of the crisis, which compounded the series of exogenous shocks to insurance operations. Politically entrenched ideas about the virtues of self-regulation, and an exaggerated faith in the ability of insider experts to know what was best for the institution also played a role. The result was an incomplete and belated misdiagnosis of what ailed Lloyd’s, and a series of institutional reforms that, while targeting the visible symptoms of the disease, failed to cure its underlying causes.

Following a brief overview of the development of Lloyd’s and its market organisation, section 2 below describes the scandals that rocked it in the 1970s and early 1980s and the response to these scandals. Section 3 examines the liability crisis and the LMX spiral that nearly brought down Lloyd’s by the mid-1990s. Section 4 describes the subsequent reforms that enabled Lloyd’s to survive, albeit in an entirely restructured form. The conclusion points to the implications of this history for the role of financial service regulation, and to the dangers for complex financial systems of traditional beliefs in the competence of experts and the efficacy of self-governance.

**1. The growth of Lloyd’s.**

Commencing in the 1680s, customers of Edward Lloyd’s coffee house transacted marine insurance for England’s growing seaborne trade. [[3]](#endnote-3) From 1734 the coffee house published *Lloyd's List,* which provided shipping intelligence to those who subscribed to the paper. In 1769, concern about gamblers moving into the market led a breakaway group of underwriters to form a new Lloyd’s. By 1774 the New Lloyd’s had 179 subscribers who enjoyed the sole right to underwrite in their premises in the Royal Exchange. This soon replaced the previous incarnation of Lloyd’s.

In the early nineteenth century Lloyd’s underwriters came under attack for the alleged inadequacy of their capital reserves. Their response was to formalise the institution. In 1811 a deed of association was drawn up, a new governing committee was established, and the first agents were appointed, who transmitted shipping intelligence, took charge of salvage and oversaw claims and ship repairs.

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As the market grew, many subscriber-members became detached from insurance operations, and became known as ‘names’, that is individuals who put up their personal wealth as capital, but who did not actively underwrite themselves. They became organised into syndicates. A name’s declared means determined how much could be insured on his behalf - women were not admitted as names until 1970 - by the syndicate’s underwriter. Solvency was, in theory, ensured by limiting the underwriting capacity of a syndicate to the assets of its members, but there was no legal limit to their liability. Although Lloyd’s was incorporated in 1871, the incorporating act was principally intended to strengthen the committee’s rule-making powers. It did not remove the unlimited personal liability of names for the losses of their syndicates.

The syndicates were not legal partnerships. At the end of every year, each syndicate was formally disbanded as a trading entity, but then usually reconstituted for the next year, often with the same membership and the same identifying number. Because claims arising from ocean-going voyages could take time to be settled, the practice developed of waiting three years from the beginning of a syndicate before ‘closing’ one year’s account and declaring a profit or loss. This three-year accounting system thus started with year one’s premium income and allowed two further years for claims to come in before the result for year one was declared. The result also included setting aside reserves for future claims that had not yet come in during the three years accounting period. How much to set aside was difficult to estimate. In the twentieth century, some types of ‘long-tail’ liability insurance produced claims that arrived decades after the policies were written. The reserve was normally set aside by buying a reinsurance policy that would pay for any future claims. This was known as ‘reinsurance-to-close’ (RITC).[[4]](#endnote-4) The reinsurer was often another Lloyd’s syndicate, sometimes the immediate successor of the syndicate paying for the RITC. Thus a name joining a syndicate with a long history of such transactions might pick up the personal unlimited liability for losses on policies written a long time before. This was a key feature of the crisis that unfolded in the 1980s.

As risks became larger and the market diversified out of marine insurance, the number of Lloyd’s members and average size of syndicates increased. In the 1880s few syndicates had more than six names. By the 1980s some had several thousand. As syndicates became larger, they became administered by managing agents who appointed the active underwriters and received a fee and a commission on the syndicate’s profits. Managing agents often ran several syndicates. During the 1970s names’ or members’ agents also emerged, who recruited names to syndicates in return for an annual fee assessed on the stamp (underwriting) capacity of their names.[[5]](#endnote-5)

Outsiders could not do business directly with Lloyd’s. They were required to hire brokers licensed by Lloyd’s, who shopped their clients’ orders for cover around the syndicates, and around insurance companies outside the market, trying to obtain the best prices and terms. By the First World War many of the larger broking firms had become limited companies. Before and after the Second World War brokers merged, leading to greater market concentration. By 1978 68 per cent of premiums at Lloyd’s were placed by the dozen leading broking firms. Lloyd’s became particularly attractive to American broking companies seeking a foothold in London market and even the largest Lloyd’s brokers found themselves vulnerable to takeover by their US counterparts.[[6]](#endnote-6)

Most managing agencies became owned by a handful of these giant broking firms. Through the agencies the brokers controlled most of the syndicates and therefore indirectly employed most of the underwriters. The potential arose for a conflict of interest between brokers who sought the lowest rates for their clients and underwriters who sought the best risks at the highest rates for their names.

**2. Expansion, scandals and governance issues.**

There was a strange duality about Lloyd’s in the twentieth century. On the one hand, it demonstrated an impressive capacity for product innovation and flexible underwriting by diversifying into new lines such as burglary, engineering, motor vehicle, aviation, trade credit and various kinds of liability and indemnity insurance.[[7]](#endnote-7) Later it extended to insure oil tankers, oil rigs, satellites, natural disasters, and large, idiosyncratic or hard-to-place risks.[[8]](#endnote-8) A major growth area was US property and casualty reinsurance, which by the 1960s accounted for about half of Lloyd’s business. [[9]](#endnote-9) Growth was accompanied by a rise in membership, from 3,157 to 6,052 between 1952 and 1968. An additional building had to be opened in 1957 to meet the demand for space.

On the other hand, Lloyd’s was also widely regarded as an elitist old boys’ club with arcane rules and opaque practices.[[10]](#endnote-10) Insurance involved a process of negotiation between brokers and a lead underwriter who specialised in that category of risk. The latter might examine what had previously been charged on risks of the same type, but the personal history of deals between the parties, trust and reputation were as important in determining whether an insurance would be made or not. Once a price was agreed, others would usually follow the lead underwriter by insuring part of the risk at that price.[[11]](#endnote-11)

By the end of the 1960s the growth in large risks such as supertankers and jet aircraft, and the losses associated with Hurricane Betsy, which hit the US Gulf coast in 1965, raised Lloyd’s awareness of the need to increase underwriting capacity.[[12]](#endnote-12) A report was commissioned from the Earl of Cromer, who recommended reducing the means-tested qualification for names and introducing a new simplified deposit scheme.[[13]](#endnote-13) Membership was opened to all nationalities and to women. The result was a surge in applications stimulated by successive years of high returns and by the tax advantages associated with membership.[[14]](#endnote-14) By 1980 the number of names reached 18,500.[[15]](#endnote-15)

As new members flooded into Lloyd’s, the market began to face a series of catastrophic tanker, oil rig and aviation disasters, scandals, and claims of negligent underwriting and poor monitoring of syndicates. [[16]](#endnote-16) The most prominent scandal was that of the syndicate Sasse, Turnbull and Co., which was suspended in 1977 when over 40 of its members refused to pay calls and formed an action group. Two years earlier, Tim Sasse, the chief underwriter, had authorized a firm in New York to insure on his syndicate’s behalf, but failed to check the reputation of the firm or the business it was doing. The New Yorkers insured derelict properties in South Bronx that promptly burned down at a cost of $25m. In 1980 the names sued Lloyd’s, alleging a failure of supervision. An out-of-court agreement was reached in which Lloyd’s shouldered two-thirds of the losses.[[17]](#endnote-17)

Such scandals drew attention to several issues that dogged Lloyd’s through the 1980s: the efficacy of its governance system, the problematic relationship between names and their agents, and the conflict of interest implicit in broking firms placing business with syndicates that they owned. The continued entry of large numbers of new names, many of them ignorant of the insurance business and not very rich, made these issues more pressing. In 1980 an inquiry chaired by Sir Henry Fisher recommended (i) the establishment of a new Lloyd’s council with greater disciplinary powers; (ii) divestment, forcing Lloyd’s brokers to sell off their underwriting interests within five years; (iii) divorce, preventing agents who recruited names for syndicates from managing those syndicates.[[18]](#endnote-18)

The first of Fisher’s main recommendations was inserted in a private bill introduced in the Commons early in 1981. The bill took up considerable parliamentary time. Key concerns were whether legislation should protect Lloyd’s members, how should the power of the large brokers be mitigated, what responsibilities should be imposed on Lloyd’s to govern the market fairly for all names, and who should monitor the rule makers? Those backing the bill argued that Lloyd’s Victorian constitution was not suited to an institution of nearly 20,000 names, most of whom had no experience of the market. The Sasse affair had demonstrated that the monitoring powers of the existing committee were ineffective.[[19]](#endnote-19)

The front benches of the Conservative government and the Labour opposition agreed on the need to preserve the principle of self-regulation.[[20]](#endnote-20) Only some on the Labour left had reservations about granting powers to an outside body without any means of supervising it in the public interest.[[21]](#endnote-21) The Conservative back benches, where over 50 names sat, were united behind self-regulation, but disunited on what that should mean in practice. Some wanted greater accountability. Some joined a campaign, organised by outside names, against a clause in the bill that granted the new Lloyd’s council immunity against legal action. Others could not see what the fuss was about. If names wanted protection ‘they shouldn’t have joined Lloyds in the first place’.[[22]](#endnote-22) In the end an amendment was agreed that safeguarded Lloyd’s council against litigation by names for negligent or fraudulent underwriting by their syndicates, but removed its immunity from claims deriving from its own negligence.[[23]](#endnote-23)

The bill that passed into law in January 1983 contained divestment and immunity provisions, but no divorce clause.[[24]](#endnote-24) The new Lloyd’s act authorised a council of 27, 16 of whom were to be elected by the working names - about 20 per cent of the total - with eight members being elected by the other four-fifths of ‘external’ names not working in the market. The remaining three members were nominated by the Bank of England. The new council was intended to be more representative than the old committee that had been elected only by working members. Nevertheless it was still stacked in favour of Lloyd’s insiders, and, importantly, it had the power to delegate decisions to a sub-committee of its working members. The act also required that brokers and managing agents divest themselves of financial interests in each other within five years. The opposition of the large broking firms was tempered by their fear of stronger legislation, and by the government’s continued support for self-regulation.

At the prompting of the Bank of England, Ian Hay Davison was appointed as the first salaried chief executive of Lloyd’s.[[25]](#endnote-25) Davison was chairman of the Accounting Standards Committee and had experience as a fraud investigator for the Department of Trade and Industry (DTI) in the 1970s. He regarded his role essentially as one of trouble-shooter, tasked with developing better accounting rules, rooting out fraud, and restoring Lloyd’s public reputation. His view was that greater transparency and the proper auditing of syndicates would allow names to act as their own police force.[[26]](#endnote-26)

Before Lloyd’s act came into effect, new scandals emerged. The first concerned the Alexander Howden agency, whose chief underwriter, Ian ‘Goldfinger’ Posgate, together with four fellow Howden directors, were accused of false accounting and siphoning off over $55m from the syndicates they ran.[[27]](#endnote-27) Howden funds allegedly had been used to invest in companies that the directors owned in Panama and Bermuda. Gifts of cash and paintings were dispensed to buy silence. Their accuser was the giant US broking firm Alexander & Alexander, which had purchased the Howden agency, but then discovered the fraud and reported it to the US Securities and Exchange Commission. Lloyd’s council was slow to react. Its chairman, Peter Green, declared that conflicts of interest at Lloyd’s were ‘no greater than running a butcher’s shop’.[[28]](#endnote-28) Only after the DTI launched an investigation and the police were brought in was Posgate suspended.[[29]](#endnote-29) There followed several years of duelling through the courts over Lloyd’s right to suspend him.[[30]](#endnote-30) Following the DTI investigation, Posgate and the others were prosecuted on charges of fraud and theft.[[31]](#endnote-31) Although acquitted at trial in 1989, Posgate never worked at Lloyd’s again.

Another scandal involved the syndicates run by the PCW agency. John Wallrock, the chairman of PCW’s owner, the broking firm Minet, resigned in 1982 after it was discovered that he and several PCW executives had personally benefitted from reinsurances made by the syndicates. PCW, its manager Peter Dixon and chief underwriter, Peter Cameron-Webb, were investigated by both the DTI and Lloyd’s.[[32]](#endnote-32) The auditors Price Waterhouse found PCW accounts in ‘an appalling state’.[[33]](#endnote-33) Total losses incurred by the syndicates between 1979 and 1985 were £130m, most of which stemmed from reinsuring US asbestos risks. The liability facing 1500 PCW names was estimated at £77m. An action group was formed to resist calls and to pursue compensation.[[34]](#endnote-34) The Conservative government rejected Labour demands for prosecutions and tighter regulation of Lloyd’s, responding that the matter was an internal affair.[[35]](#endnote-35) In 1985 Lloyd’s investigation reported that Dixon, ‘a clever, dishonest, greedy and unscrupulous individual’, had used a web of bogus reinsurance deals to channel PCW funds into his own offshore companies and other property.[[36]](#endnote-36) Dixon was fined £1m and expelled from Lloyd’s, although the fine could not be collected as he fled to Costa Rica. Cameron Webb escaped to the US. He and Wallrock were also expelled, and all three were barred from acting as company directors.[[37]](#endnote-37)

**3. Liability crisis, LMX spiral and collapse.**

The Howden and PCW affairs were the most prominent of several scandals that centred on the fraudulent use of syndicate funds. A larger and more damaging category of scandal concerned negligent or incompetent underwriting, especially of ‘excess of loss’ (XL) reinsurance. By 1991 it was estimated that some 20 per cent of all names at Lloyd’s had organised into action groups to sue their syndicates for losses due to poor underwriting, and to pursue Lloyd’s for compensation because of supervisory failures.[[38]](#endnote-38)

The highest profile cases involved the Outhwaite, Feltrim and Gooda Walker syndicates. In 1991 nearly 1000 names sued the managing agents of Richard Outhwaite’s syndicate for £150m for his reckless underwriting that had led to losses of £260m.[[39]](#endnote-39) The agents were sued because they carried ‘errors and omissions’ (E&O) insurance against which compensation was sought. In 1982 Outhwaite had written 31 ‘run-off’contracts that reinsured other syndicates against the risk of asbestos claims in the US. Some of the policies reinsured dated back to the 1940s. It was alleged that Outhwaite, a marine underwriter, knew ‘virtually nothing’ about this area of insurance, that the premiums he had charged were too low, and that he had failed to take into account the surge in asbestos-related injury claims in the US at the time he wrote the policies. Lloyd’s investigated, but, finding no evidence of fraud, refused to take further action.[[40]](#endnote-40) Yet claims continued to roll in on the 1982 account, so that it could not be closed. Outhwaite acted as a test case for suits against other syndicates.[[41]](#endnote-41) After four months at trial the names settled out of court for £116m, mostly paid for by the E&O policies.[[42]](#endnote-42)

Another case concerned the syndicates managed by Feltrim Underwriting Agencies, which between 1987 and 1990 ran up $380m of losses on XL reinsurance of catastrophe risks, such as hurricane damage.[[43]](#endnote-43) The average Feltrim name, who had committed £30,000, faced a loss of £160,000. After he resigned, the chief underwriter, Patrick Feltrim Fagan, admitted that the reinsurances had been flawed, yet his auditors, Arthur Andersen, had signed off the accounts and new names continued to be recruited through 1989.[[44]](#endnote-44) Furthermore, Lloyd’s had withdrawn $24m from the capital of the Feltrim syndicates to cover the liabilities of their predecessors dating back to 1983, leaving only $4m of reserves to meet the vast claims and to reinsure against future losses.[[45]](#endnote-45)

A third major scandal involved the syndicates managed by Anthony Gooda and Derek Walker, which lost more than $1.7bn in writing XL reinsurance. [[46]](#endnote-46) Lloyd’s commissioned separate reports into this and Feltrim. Both reached the same conclusions: first, that members’ agents had failed to look after their names’ interests; second, that managing agents were incompetent and uninformed; third, that the underwriters did not understand XL catastrophe reinsurance and had made a mess of it. The most serious charge was that insiders knew things were going wrong and took advantage of this by dumping their worst risks on to the stricken syndicates at absurdly low rates.[[47]](#endnote-47) In 1993 the administrators of Gooda Walker revealed that staff-bonuses and company cars were being improperly charged to names as late as 1991, shortly before it went bust. The House of Lords ruled that a 3,100-strong names’ action group could sue Gooda, Walker and 71 members’ agents.[[48]](#endnote-48) The names alleged that the syndicates had appalling record-keeping and information systems and that they had displayed spectacular incompetence by breaching the cardinal principle that risks should be spread, not concentrated.[[49]](#endnote-49) Former Gooda Walker underwriters testified that their directors had encouraged the losses to be covered up.[[50]](#endnote-50) An expert witness, Ulrich von Eicken, a former Munich Re executive, claimed that Gooda Walker had failed to write a balanced book of business, had failed to calculate and reinsure their exposure, and had failed properly to rate the business they wrote. It was an ‘aberration of catastrophe excess of loss business and should probably not have been touched by anybody’.[[51]](#endnote-51) The trial judge, Mr Justice Phillips, ruled that Gooda Walker had been negligent and that it owed a duty of care to all its names.[[52]](#endnote-52)

This new generation of scandals was on a scale vastly greater than the earlier frauds. The scale derived from the large number of names involved, the long-tail nature of the asbestos and industrial pollution risks generating many of the losses, the enormous upsurge in catastrophe losses during the later 1980s, and the spiral of liabilities that the writing of XL reinsurance produced across the market. Asbestosis and pollution claims in the US, which had concerned some at Lloyd’s in the late 1960s, began to pour in, some on policies dating as far back as the 1930s.[[53]](#endnote-53) By 1982 US asbestosis claims alone were estimated at $100bn. One US corporation, Manville, filed for bankruptcy because of thousands of lawsuits and sought $5bn from its insurers, including some at Lloyd’s, to meet claims.[[54]](#endnote-54) Following Manville’s bankruptcy, the UK’s biggest asbestos producer, Turner & Newell admitted that it was involved in about 1000 asbestosis claims, though many were dismissed without payment and average settlements were small.[[55]](#endnote-55) In contrast to the generosity of US courts, low levels of compensation paid to victims in the UK meant that as late as 1982 Turner & Newell still did not insure against asbestosis claims.[[56]](#endnote-56)

These long-tail liabilities were compounded by an upsurge in large catastrophe losses, including those from storms, earthquakes, hurricanes, the Piper Alpha oil platform explosion, the Exxon Valdez tanker spill, and the Gulf war of 1990-1.[[57]](#endnote-57) As new names flooded into the market, underwriters increasingly competed for catastrophe business and more syndicates like those of Outhwaite, Gooda Walker and Feltrim wrote these risks in the form of XL reinsurance. Under these contracts the reinsurer agreed to indemnify the reinsured in the event of the latter sustaining a loss in excess of a pre-determined figure, which was the liability to be retained by the reinsured. The reinsurer in turn usually retroceded some of the amount reinsured to another insurer. Many marine underwriters like Outhwaite went into this market even though they had little experience of reinsuring catastrophe risks. Some syndicates doing XL reinsurance retroceded to other XL syndicates, so that instead of the risks being dispersed, the classic function of reinsurance, they circulated again and again around the same market, becoming increasingly opaque and concentrated in a few syndicates. This became known as the infamous London Market Excess of Loss (LMX) spiral.[[58]](#endnote-58)

A simplified graphic of the LMX spiral is shown in figure 1. XL reinsurance was placed in vertical layers, each with a different premium rate attached to it. One reinsurer would cover a layer of risk in excess of the first insurer’s retention limit. A second reinsurer, the retrocessionary, would insure the next layer of risk, where claims exceeded the threshold provided by the first insurer’s retention limit plus the first layer of reinsurance. Underwriters could also write ‘stop-loss’ policies for individual names on their syndicates to protect them against losses over a certain amount. A collection of stop-loss polices could also be reinsured, and in turn retroceded by the reinsurer.[[59]](#endnote-59)

In theory, this process should have helped disperse risks by bringing in more insurers to provide cover. Because the probability of losses occurring in the upper layers of risk (XL 1.1 and 2.1in figure 1) is lower, the premiums and administrative costs charged for these upper layers are lower. However, when a loss occurred that was so big as to trigger the reinsurance on these higher layers of risk, the claims were often large in proportion to the premiums received. The defect at the core of the spiral developed when some syndicates writing XL reinsurance took out XL cover themselves. Those who reinsured them were therefore writing XL risk on XL risk. The latter, in turn, frequently also took out XL cover. Thus there developed a spiral of mutual reinsurance. When a catastrophic loss occurred, claims were passed on, minus retentions, between syndicates in a complex game of pass the parcel. The first to exhaust their layers of XL reinsurance protection were left holding the liability parcel. The effect was to magnify many times the volume of loss, because claims were repeatedly made in respect of the same loss.[[60]](#endnote-60)

To illustrate this, consider an oil rig insured for £100m, but whose insurer only want to retain half of the risk, ie. does not want to pay out more than £50m should a claim come in. So the insurer decides to reinsure the first £25m in excess of a loss of £50m (XL 1) with reinsurer 1. The second layer of risk above this, ie. any loss between £75m and £100m (XL 2), is reinsured with reinsurer 2. The two reinsurers, for their part, only want to retain half of the layers of excess loss that they have accepted, so they retrocede £12.5m each to retrocessionaries 1 and 2 respectively (XL 1.1 and XL 2.1). If the oil rig catches fire and is only half destroyed, the total claim of £50m falls on the insurer, without a claim being made on either reinsurer. However, if the rig is entirely destroyed, the policyholder claims £100m from the insurer; the insurer claims the two £25m excess of loss risks (XL1 and XL2) reinsured with reinsurers 1 and 2; and the two reinsurers claim the £12.5m that they each retroceded from their retrocessionaries (XL 1.1 and XL 2.1). Thus the gross claim amounts to 175 per cent (100+25+25+12.5+12.5) of the insured loss. Net claims, once finally settled, will come to 100 per cent of the loss, but this shows how XL reinsurance could greatly inflate the volume of claims circulating during a settlement period.[[61]](#endnote-61)

The LMX spiral was kept turning by several factors. In the years before the huge syndicate losses, high returns enticed many into this business. XL premiums rose by 201 per cent between 1983 and 1988 compared to a 61 per cent increase for Lloyd’s market as a whole.[[62]](#endnote-62) By 1990 over one quarter of the business at Lloyd’s was XL reinsurance.[[63]](#endnote-63) Lloyd’s own accounting rules encouraged XL business to be kept within the market by crediting 100 per cent of any reinsurance bought there as reserves, but only 80 per cent of reinsurance bought outside the market.[[64]](#endnote-64) As more capacity entered XL business, underwriters were encouraged to reinsure more and to keep their retention rates low. Lloyd’s was later accused of failing properly to monitor syndicate underwriting capacity, the rates being charged or the provenance of the risks being insured. The spiral offered brokers, underwriters and managing agents commission and fees on every reinsurance and retrocession written, and in the wake of the losses many names accused their agents of gouging them. XL business also enabled underwriters to arbitrage by profiting from the differential between the premiums received for the insurance, and the lower premiums paid out for reinsurance and retrocessions. These opportunities multiplied where those writing at the top of the spiral accepted, out of ignorance or carelessness, premium rates that were far too low for the higher layers, believing that these layers were virtually risk free. Such arbitrage thus increased the moral hazard of underwriters insuring without much concern about their fiduciary obligations to their names.[[65]](#endnote-65)

XL reinsurance also offered a means by which unscrupulous underwriters could offload the worst risks onto ‘dustbin’ syndicates of outsider names, while picking the best risks to be reinsured or retroceded with so-called ‘baby’ syndicates of insiders, including brokers, underwriters, agents, Lloyd’s executives and few favoured names.[[66]](#endnote-66) The Walker report of 1992 into the LMX spiral discovered that the syndicates with the lowest percentage of working names had the highest percentage of losses, indicating that a disproportionate share of losses had fallen on unsuspecting non-working names.[[67]](#endnote-67) Poor information recording exacerbated these principal-agent problems. Because of the lack of filing space on the floor of Lloyd’s and customary practice, underwriters relied on brokers to maintain essential records, keeping only ‘skeleton cards’ with the barest details of what had been insured. The lack of a paper trail made it difficult to close the books on older syndicates or to track risks insured in the LMX spiral.[[68]](#endnote-68)

It is important to note, as the Walker Report does, that only a minority (87) of syndicates wrote significant amounts of XL reinsurance. Many syndicates that focused on other staple lines employed experienced and technically proficient underwriters who insured cautiously and profitably. Moreover, the heaviest XL losses were concentrated in just a dozen or so syndicates.[[69]](#endnote-69) Nevertheless, these losses were so huge that they damaged the whole market, especially when Lloyd’s, in its desperation to meet claims, decided to mutualise the losses through market-wide levies to replenish its central fund.[[70]](#endnote-70)

**4. Reform, survival and recovery**

While the LMX spiral was gaining momentum, new names continued to flood into Lloyd’s. Membership reached a peak of over 32,000 in 1988 (see table 1). Yet there were already signs of growing public concern about Lloyd’s. In 1985 Ian Hay Davison resigned after a disagreement with Peter Miller, chair of council, over his role as CEO.[[71]](#endnote-71) This resignation, together with the ongoing scandals, led to questions in Parliament. In 1986, during the debates on the Financial Services bill to establish a new Financial Services Authority (FSA), Labour MPs denounced Lloyd’s as ‘a school for scandals’, and demanded that it be included in the bill.[[72]](#endnote-72) The Thatcher government rejected this, arguing that the purpose of the FSA was to regulate investment not insurance, though it did appoint an inquiry, chaired by Sir Patrick Neill, into Lloyd’s governance.[[73]](#endnote-73) The debates revealed that political alignments had begun to shift. Labour’s front bench had moved decisively towards support for an independent regulatory body for Lloyd’s, although Liberal Democrats were not prepared to go this far.[[74]](#endnote-74) Labour back-benchers attacked Lloyd’s as a nest of corruption and called for state supervision. Many Conservative backbenchers remained in favour of self-regulation, but were increasingly worried about investor protection. Some were moving closer to Labour’s position. The Bow Group of so-called ‘Tory wets’ called for Lloyd’s to be brought under the auspices of the FSA.[[75]](#endnote-75) The Conservative government continued to support self regulation, while outside parliament, resistance to change came from Lloyd’s council, the large broking firms, ‘traditionalists’ and those wealthier names who were best able to spread their investments around a range of syndicates.[[76]](#endnote-76) The Neill committee reported in 1987 and recommended increasing the representation of non-working names on Lloyd’s council, but this was no solution to the tidal wave of insurance claims about to crash over the market.[[77]](#endnote-77)

In the early 1990s, after years of record losses (see table 1), the resistance to calls, the lobbying and law suits reached a crescendo. The most common grounds for legal action was that names had been misled when they became members, that Lloyd’s had failed to disclose material financial information, had failed to supervise properly, and had operated a market where insider cliques reaped huge rewards at the expense of outsider investors. In 1993 Lloyd’s offered a settlement of £900m to nearly 20,000 names on all the syndicates that were the object of suits. The settlement was to be paid for by Lloyd’s central fund, by E&O insurance, and by contributions from agents and brokers. Set against total losses of £3.2 billion, it was not a generous offer: less than 30p in the pound, and names would continue to be liable for future losses on past years of account.[[78]](#endnote-78) Several action groups rejected the offer, partly because its conditions removed their right to sue auditors or to refuse future cash calls. Above all, names desire some cap on any future liability for losses.[[79]](#endnote-79)

The new Lloyd’s chairman, David Coleridge, pushed through a series of measures, while remaining publicly optimistic about future profits, even though three of the worst years of account (1990-2) remained open. A task force to examine structural reforms was established under David Rowland, Coleridge’s successor as chair of council.[[80]](#endnote-80) Two internal inquiries were commissioned, one to examine the LMX spiral, chaired by Sir David Walker, and the other to examine governance, chaired by Sir Jeremy Morse. Both reported in July 1992. Walker found no evidence of fraud but recommended a greater transparency of information and a tighter supervision of reinsurance. Morse recommended a separation of regulatory and business functions in a smaller Lloyd’s council, to be chaired by a salaried executive who was not active in the market.[[81]](#endnote-81) A special levy across the market was also introduced to rescue Lloyd’s ‘lifeboat’, its central fund, which had been drained by trying to cover the growing claims on syndicates whose names resisted calls. In 1993, in a breach of its own accounting procedures, some of the profits made that year were brought forward to replenish the fund further.[[82]](#endnote-82)

The mid-1990s were a period of critical transition for Lloyd’s. As table 1 shows, names rushed to the exit door as losses continued to roll in. Lloyd’s council became engaged in a desperate struggle on several fronts, facing a widespread resistance to calls, law suits brought by large groups of names, and claims that its preferential treatment of reinsurance bought inside the market breached EC competition rules. In dealing with distressed, rebellious and litigious names, the council adopted a carrot and stick approach, which in turn comprised promises of support to settle losses and pursuing vigorously the assets of names who resisted calls.[[83]](#endnote-83) The rejection of the settlement was quickly followed by the appointment of professional debt collectors and the establishment of a Financial Recoveries Department. In particular, Lloyd’s tried to go after the awards made by courts to names who had successfully sued. When the courts denied it the right to seize such awards, Rowland instructed names’ agents to issues writs against their own names on pain of being disqualified from the market.[[84]](#endnote-84)

While continuing to defend self-regulation, Lloyd’s accepted several fundamental changes recommended by Rowland’s task force when it reported in 1993. For the first time in its history, Lloyd’s permitted the entry of corporate investors with limited liability. The old boys’ club disappeared remarkably quickly.[[85]](#endnote-85) The first corporate members joined in 1994, and they were soon permitted both to control managing agencies via holding companies, and to put up the majority of the underwriting capacity of a syndicate. Some syndicates became wholly owned by a single insurance company. Corporate capital soon accounted for 80 per cent of market capacity.[[86]](#endnote-86) The number of individual names collapsed (see table 1) and names’ agencies all but disappeared. Where there had been 270 in 1982, there were just three by 2013. [[87]](#endnote-87)

A new vehicle was created, dubbed Equitas and structured as a trust, to reinsure all liabilities incurred by syndicates prior to 1993, to be funded by a levy on Lloyd’s remaining members.[[88]](#endnote-88) In 1996 Lloyd’s finally achieved a £3.1 billion settlement with litigants.[[89]](#endnote-89) In 1998 the new Labour government announced that Lloyd’s would be independently regulated by the FSA, a reversal of the decision of 1986.[[90]](#endnote-90) In 2002, in the midst of further heavy losses, an annual accounting system was adopted.[[91]](#endnote-91) While these and other reforms were taking place, Lloyd’s also became a more concentrated market, as mergers and acquisitions swept across UK insurance. Between 1991 and 2002 the number of brokers operating at Lloyd’s fell from 244 to 126, managing agents from 151 to 49, and syndicates from 400 to 86. By the end of this period the three largest broking firms accounted for 61 per cent of Lloyd’s business.[[92]](#endnote-92)

Lloyd’s emerged as a radically different organisation from its historical predecessor. Much market share had been lost, especially to corporate insurers and brokers based in Bermuda.[[93]](#endnote-93) Nevertheless, Lloyd’s remained important in the markets it had long specialised in: reinsurance, aviation, offshore oil and gas rigs, and marine insurance. In 2012 a pre-tax profit of £2.8bn was posted on a gross premium income of £25.5bn. In the five years ending in 2012 the average return to investors was 12.1 per cent.[[94]](#endnote-94)

**5. Conclusion – delusions of competence**

Several factors brought Lloyd’s to a tipping point at the end of the 1980s. Certainly the inexperienced names entering the market exhibited signs of contagious behaviour.[[95]](#endnote-95) One PCW victim told a reporter in 1985 that she had ‘somehow got sucked into it’. She had been left £100,000 from her father and had been persuaded to join a syndicate by a Lloyd’s agent to whom she had happened to sell a flat. ‘They want £260,000 from me [in calls to meet losses]. I’m a secretary, I only earn £100 a week’.[[96]](#endnote-96) More cynically, one might view the flood of new entrants as a manifestation of a culture of greed, in which the unwary were lured by ease of entry and by promises of tax advantages and high returns for little effort or risk.[[97]](#endnote-97)

Yet the crisis involved more than a bubble of contagious speculation. A wave of catastrophe and liability losses far in excess of the normal underwriting cycle, tax changes, falling returns, scandals and frauds, together combined to make Lloyd’s less attractive to unlimited liability investors by the early 1990s.[[98]](#endnote-98) The failure of the governance reforms of 1981-7 to be accompanied by changes to operating procedures and underwriting practices indicated inertia, although it is unlikely that such changes would have mitigated the effects of long-tail losses deriving from policies written much earlier. Legal actions and political lobbying by names heaped pressure on Lloyd’s to accept structural reforms and to mutualise outstanding liabilities, while growing scepticism about self-regulation pulled support from under the feet of the traditionalists. The political debates between 1981 and 1992 clearly reveal a shift in Parliament and the press towards an acceptance of the need for independent statutory supervision. It took the confluence of these factors to transform Lloyd’s.

Experts, led by Hay Davison, attempted to implement constitutional change and improve professionalism, but the symptoms presented did not lead them to a full diagnosis of the disease. This had two separate but related layers of infection, one almost invisibly buried under the other. The most visible, which produced malfeasance and misgovernment, was the easiest to treat. The governance and accounting reforms of the 1980s, although only partially complete, may have temporarily alleviated some of the symptoms. While the market continued to rapidly, many thought that the patient would make a good recovery. By 1988, however, constitutional reforms alone could not remedy the underlying and most fatal layer of the Lloyd’s disease, the toxic process by which risks were insured and reinsured and the unwarranted faith in the competence of those managing that process.

A belief in the traditional ways of doing things compounded the ailment. There were two aspects of this. First, tribalism and hierarchical attitudes abounded. Brokers regarded underwriters, some at least, as vain and lazy. Underwriters viewed members’ agents as a ‘lesser breed’. The staff of Lloyd’s were seen by both underwriters and brokers as inferior and ‘uncommercial’. All working members regarded the place as special and themselves as superior to those employed by outside insurance companies.[[99]](#endnote-99) Second, these feelings of superiority did not derive from an extensive formal education. Lloyd’s underwriters rarely had any professional qualifications or a university degree. Many began at Lloyd’s as teenage ‘entry boys’, sitting at the box near the junior and senior underwriters, learning how deals were made with brokers, noting the decisions made on filing cards. If they were reasonably bright, and fitted in well with the lunchtime drinking culture, they would gradually work their way up the seniority system until they became chief underwriter for a syndicate.[[100]](#endnote-100) The sense of superiority came from surviving in this system, being a member of an exclusive club, and making lots of money.

An inflated confidence in their own abilities led underwriters into the LMX spiral, a market many did not understand and whose risks they did not know how to price. This was not due to a lack of experience. Those who made the massive losses for the Gooda Walker syndicates, for instance, were no Johnny-come-latelies or young Turks seeking to gamble with their names’ funds. Stan Andrews, the underwriter for syndicate #298, was born in 1930, joined the Gooda agency in 1954 , and was aged 64 at the time of the Gooda Walker trial. Anthony Willard, who wrote for syndicate #299, joined Lloyd’s aged 16 in 1951 and became marine underwriter for Gooda Walker in 1968. He was 59 at the time of his trial. Derek Walker was born in 1928, began working in Lloyd’s in 1943, started syndicate #290 in 1974 with 100 names. By 1989 the latter had 3,163 names. He was aged 66 at his trial. In other words, they were all long-established insiders who had worked their way up through the market. Yet it proved hugely damaging for these men to rely on their past experience when writing XL risks that required specialist knowledge and an expert consideration of rating and exposure. Setting premiums by intuition and ‘gut feeling’ would not do in a world of rapid technological and environmental change, and unprecedented losses from natural catastrophes and long term liabilities.[[101]](#endnote-101)

Lloyd’s not only provides a lesson about the weakness of self regulation and the inefficiency of the competitive market to weed out poor business practices. It also reveals the damage that can be caused to a financial system by dogmatic belief in the competence of experts. The assertion by Lloyd’s insiders of their right to self-regulate rested on their expertise and the mysteries of a trade rooted in customary practices. Before the 1980s this assertion, and widespread ignorance of how Lloyd’s operated, had convinced generations of politicians to leave the market alone. But the claims proved to be a chimera in the face of market forces, climate shocks and changes in the nature of risk.

Lloyd’s underwriters’ claim to expertise rested on their tacit knowledge, their accumulation of know-how.[[102]](#endnote-102) This type of knowledge is associated with intuition and a reliance on the heuristic or rule of thumb.[[103]](#endnote-103) This facilitates the decision making required in a fast moving insurance market like Lloyd’s. As experimental psychologists have shown, however, it also generates systematic biases and errors in predictions. In particular, people tend to judge a risk based on the ease with which instances of it come to mind. They also often ignore the effects of random variation in small samples, and wrongly apply the law of large numbers to them.[[104]](#endnote-104) The problem of the LMX spiral was that the institutional environment at Lloyd’s, and the lack of professional education among underwriters, constrained the ability of scientific knowledge and rational analysis to feed into and inform tacit knowledge and re-shape business practices.[[105]](#endnote-105)

Those with experience of Lloyd’s in the 1980s observed arrogance and a ‘prima donna culture’ among the top underwriters.[[106]](#endnote-106) Robert Browne recalled an underwriter from Munich Re telling an audience, with only a little exaggeration, that ‘we Germans use technical rates. In London they use ceiling rates. The underwriter reads the slip, looks at the ceiling, and puts down the first number which comes into his head’.[[107]](#endnote-107) As modern studies have shown, the success of intuitive decision making depends greatly on the predictability of the environment in which decisions are made.[[108]](#endnote-108) It can deliver profits in the market for staples such as marine and aviation insurance, where risks were usually discrete and well-known. However, as intuition is the product of associative memory and recognition, it can lead decision-makers, when confronted with a difficult problem, to simplify the decision, rather than apply a more sophisticated decision rule based on fuller information.[[109]](#endnote-109) In the case of underwriters, it may lead them to underinsure against low probability-high loss events, or to avoid seeking out additional information when confronted with adverse news - the ostrich effect that has been observed of professional investors.[[110]](#endnote-110) Howard Kunreuther and colleagues have argued that rich context information is necessary for insurers to be able to judge the differences between low probability risks, or to price risks accurately where there is ambiguity about event probability or uncertainty about the scale of possible losses.[[111]](#endnote-111) The information systems and deal making practices employed at Lloyd’s did not lend themselves to the acquisition and analysis of such rich contexts.

It is not the object of this paper to present a full exposition of the scholarly literature on decision making under uncertainty, risk behaviour and the fallacies of experts. Many of the findings of this literature, however, do appear useful in helping to explain the behaviour at Lloyd’s. A belief in the superiority of their knowledge among underwriters in the LMX spiral, excluding the outright fraudsters, may have led to overconfidence and ‘cognitive dissonance’ - an inability to know the limits of their expertise.[[112]](#endnote-112) Overconfidence, in turn, may have led to an optimistic bias; to persistence in operating according to established beliefs; to ‘tunnelling’, the instinct to make inferences too quickly and to focus on a small number of known sources of uncertainty; to ‘herding’, the desire to avoid being an outlier in one’s predictions, which has been widely observed of professional economists and financial forecasters; and to ‘confirmation bias’, whereby experts try to interpret evidence with the aim of corroborating the rules that they had made up.[[113]](#endnote-113) The practice at Lloyd’s of syndicate underwriters ‘following’ the premium rate set by a recognised ‘lead’ underwriter, would have reinforced these behavioural traits. The combined effect of these behaviours on XL underwriting at Lloyd’s would have been a heightened tendency to ignore ‘black swans’, the unknown or unimagined events that can deliver catastrophic losses.[[114]](#endnote-114) There are obvious parallels with the behaviour of investors in the market for sub-prime mortgage default risk whose collapse brought about the global financial crisis of 2007-8.[[115]](#endnote-115)

By 1988 no amount of internal governance and accounting reform, no further degree of invasive surgery to the organs of the institution, could have saved Lloyd’s from collapse. Fundamental flaws lay buried in market’s closed structure and its out-dated practices that proved vulnerable to the cataclysmic losses arising in the 1980s and 1990s. These core weaknesses, however, were nurtured by multiple delusions of competence: the faith of underwriters and brokers in their own know-how; the belief of politicians, successive governments and Lloyd’s insiders in the institution’s ability to govern and regulate itself; the trust placed by names and policyholders in Lloyd’s and its experts. These external and internal delusions of competence reinforced each other and produced near fatal barriers to change.

**Table 1: Lloyd’s membership and profits/losses**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Year | Names | Profits/Loss $m | Year | Names | Profits/Loss $m |
| 1870 | 378 |  | 1990 | 28,770 | -4128 |
| 1933 | 1,532 |  | 1991 | 26,531 | -3625 |
| 1952 | 3,157 |  | 1992 | 22,259 | -2112 |
| 1968 | 6,052 |  | 1993 | 19,537 | 338 |
| 1971 | 6,020 | 185 | 1994 | 17,624 | 161 |
| 1972 |  | 224 | 1995 | 14,884 | 1815 |
| 1973 |  | 270 | 1996 | 12,811 | 945 |
| 1977 | 10,618 | 228 | 1997 | 9,972 | -343 |
| 1978 |  | 334 | 1998 |  | -1643 |
| 1979 |  | 367 | 1999 |  | -3078 |
| 1980 | 18,552 | 822 | 2000 |  | -2614 |
| 1981 |  | 501 | 2001 |  | -4478 |
| 1982 | 20,145 | 284 | 2002 | 2,490 |  |
| 1983 |  | 182 | 2006 |  | 6738 |
| 1984 | 23,436 | 373 | 2007 |  | 7692 |
| 1985 | 26,050 | 254 | 2008 |  | 3513 |
| 1986 |  | 954 | 2009 |  | 6073 |
| 1987 | 31,500 | 835 | 2010 | 773 | 3402 |
| 1988 | 32,433 | -908 | 2011 |  | -826 |
| 1989 | 31,329 | -3383 | 2012 |  | 4406 |

Sources: Names: 1870, 1933: Cockerell and Green (1994), p.18; 1952, 1968, 1982: Cockerell (1991), p.280; 1971: *The Times* 11 August 1975; 1977: *The Times* 23 June 1977; 1980: *The Guardian* 21 July 1990; 1982, 1985: *The Guardian* 29 July 1985; 1987: Davison (1987), p.44; 1988-94: *The Economist* 3 December 1994; 1995-7?; 2002: *Sigma* 2002; 2010, Browne (2010).

Sources: Profits/Losses: 1971-79: *The Times* 11 August, 29 August 1975, 27 August 1976, 5 September 1980, 28 August 1981, 27 August 1982; 1980-97: Duguid (2014), appendix 4; 1998: [www.truthaboutlloyds.com](http://www.truthaboutlloyds.com); 1999-2001: *Financial Times* 11 April 2002; 2006-12: Lloyd’s Annual Reports 2010, 2012.

Notes: Profit = net underwriting profits (net of expenses) + investment income, see *The Times* 6 September 1985, reporting on the 1982 year of account, and *The Economist* 24 August 1991 reporting on the 1988 year of account. Profits/losses given in sources in £ are converted to US$ at contemporary annual rates from MeasuringWorth.com, except for the year 1998, which is calculated by the source, [www.truthaboutlloyds.com](http://www.truthaboutlloyds.com), using a fixed exchange rate of £1=$1.55. This is lower than the average rate for these years ($1.60) from MeasuringWorth.com. Lloyd’s three year closed accounting system means that, for example, the profit of 1990 is the premiums written in 1990 minus claims settled within the following three years. This applies to all years through to 2000. In 2002 Lloyd’s moved to a system of annual reporting, beginning with the result for 2001. *Financial Times* 11 April 2002.**Figure 1: The excess of loss reinsurance spiral**

**Bibliography**

XL2

XL1

Insurance retained by direct insurer

XL 1.1

XL 1

to

Reinsurer 1

XL 1.1 to Retrocessionary 1

XL 2.1

XL 2 to Reinsurer 2

XL 2.1 to Retrocessionary 2

High

Low

Pre-

miums

and

Proba-bility

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**Notes**

1. On the insurance market before and after the San Francisco fire, see Pearson and Lönnborg (2005); Röder (2006); Trebilcock (1998). On the longevity of modern underwriting practices in reinsurance, see Jarzubowksi (2015). [↑](#endnote-ref-1)
2. Hodgson (1986); Mantle (1992); Gunn (1993); Raphael (1995); Luessenhop (1995); Proctor (1996); Duguid (2014). The impact on direct insurers of the liability reinsurance crisis, and of Lloyd’s financial distress, have been examined, respectively, by Berger, Cummins and Tennyson (1992), and by Fields, Klein and Myskowski (1998). Neither discuss the situation at Lloyd’s at any length. [↑](#endnote-ref-2)
3. The following is based on Wright and Fayle (1928); Kingston (2007); Pearson (2004, 2006). [↑](#endnote-ref-3)
4. For an overview of RITC, see Rice and White (1990). [↑](#endnote-ref-4)
5. Luessenhop (1995), pp. 72, 108, 127. [↑](#endnote-ref-5)
6. For examples, see *The Times* 23 January, 20 December 1980. [↑](#endnote-ref-6)
7. Brown (1980); Pearson (1994). [↑](#endnote-ref-7)
8. One example of the latter was actress Elizabeth Taylor’s Cartier diamond, which was insured for $1.2m at a cost of $66,000 premiums, on condition that it was taken out of its vault for no more than 30 days in any one year, and under armed guard. *The Times* 2 January 1970. [↑](#endnote-ref-8)
9. Werner (2007). [↑](#endnote-ref-9)
10. Bertie Hiscox, a future deputy chairman, found Lloyd’s in the 1960s frequented by ‘the thick pin-striped boy made a member by his daddy…I thought I’d come to a place for the mentally disabled’. Cited by Luessenhop (1995), p. 100. Some syndicates in the early 1970s still insisted on writing with quills. Brown (1973), p. 10. [↑](#endnote-ref-10)
11. For a description of the traditional underwriting process, see Brown (1973), pp. 12-13. The process had similarities with that still used very recently by reinsurance companies, as described by Jarzubowksi (2015). [↑](#endnote-ref-11)
12. Hurricane Betsy led to three consecutive years of losses at Lloyd’s 1965-7, and the exit of members, a decline not reversed until 1971. Davison (1987), p. 43. [↑](#endnote-ref-12)
13. *The Times* 9 April 1970, 11 August, 4 November 1975. Cromer’s report also criticised the way that Lloyd’s was organised and the quality of information made available to names, but this was ignored (the report was never published). [↑](#endnote-ref-13)
14. There were successive years of record profits 1971-3, though much of this derived from higher investment yields and reduced expenses rather than from underwriting. *The Times* 27 August 1976. Syndicate earnings went directly into Lloyd’s Special Reserve Fund, for which names received a bond. Interest from the bond was taxed as income, but capital gains on the bond were taxed at a lower rate. This system of ‘bond washing’ helped wealthy names avoid paying the higher band of UK income tax, a loophole that was not closed until 1988. Luessenhop (1995), p. 112. A further attraction was that much of Lloyd’s income was denominated in US $, which appreciated against £ sterling throughout the period. [↑](#endnote-ref-14)
15. *The Guardian* 21 July 1990. [↑](#endnote-ref-15)
16. The *Amoco Cadiz*, for example, broke up in a storm in 1978, leaking 230,000 tons of oil onto the beaches of Brittany. This cost Lloyd’s over $31m, including payments into a French government fund to compensate Bretons for sea pollution. *The Times* 18 March, 29 April, 2 October, 13 November 1978, 5 November 1980, 21 April 1984. [↑](#endnote-ref-16)
17. Davison (1987), p. 46; *The Times* 25 July 1980. Lloyd’s recovered $7m of this from Sasse’s Brazilian reinsurers in 1981. *The Times* 18 June 1981.There were suspicions that the company owning the Bronx properties had Mafia connections. Luessenhop (1995), pp. 135-9. [↑](#endnote-ref-17)
18. Lloyd’s of London (1980). [↑](#endnote-ref-18)
19. House of Commons Debates 24 March 1981 vol. 1, cc. 859-94. [↑](#endnote-ref-19)
20. House of Commons Debates 24 March 1981 vol. 1, cc. 871 (Davis), 867-8 (Eyre). [↑](#endnote-ref-20)
21. House of Commons Debates 24 March 1981 vol. 1, cc. 881-3 (Cryer). [↑](#endnote-ref-21)
22. *The Times* 23 February 1981. On the Association of External Names, see the letter to *The Times* 16 March 1981. On opposition to the immunity clause, see House of Commons Debates 24 March 1981 vol 1 c. 880-3, 888-90; ibid., 22 February 1982 vol. 18, cc. 686-720. [↑](#endnote-ref-22)
23. *The Times* 15 July 1981; House of Commons Debates 3 February 1982 vol. 17, c. 370 (Grant), c. 392 (Eyre); ibid., 22 February 1982 vol. 18, c. 697 (Aitken), cc. 688-9 (Bonsor), cc. 712-14 (Grant). [↑](#endnote-ref-23)
24. Eliz. II (1982) chap. xiv (23 July 1982). [↑](#endnote-ref-24)
25. *The Times* 6 January 1983. [↑](#endnote-ref-25)
26. Davison (1987), pp. 6-7. [↑](#endnote-ref-26)
27. Posgate (1932-2017) had been elected to the old Lloyd’s committee in 1982 on a ticket of ‘free trade for underwriters’. He was reported to have annual earnings of £600,000. The marine syndicates that he ran for Howden were the largest and most successful at Lloyd’s. *The Times* 14 January 1982, 12 January 1983. Obituaries include *The Times* 3 Aug 2017*, The Telegraph* 12 July 2017*, The Insurance Post* 14 July 2017*.*  [↑](#endnote-ref-27)
28. *The Times* 12 October 1982. [↑](#endnote-ref-28)
29. *The Times* 24 September (editorial), 9 October 1982. [↑](#endnote-ref-29)
30. This can be followed in *The Times* 12 January, 27 January, 7 February, 8 February, 1 March, 22 March, 15 December 1983. In 1985 Lloyd’s reprimanded Posgate for ‘discreditable conduct’ and ‘negligence’ and expelled him for life, but upon appeal this was reduced to another temporary suspension. *The Guardian* 13 February, 9 May, 10 May, 10 July 1985, 15 January 1986 [↑](#endnote-ref-30)
31. On the DTI inquiry and the 72 charges levied against Posgate and the Howden ‘gang of four’, see *The Guardian* 7 June, 3 September 1988, 30 August 1990. [↑](#endnote-ref-31)
32. *The Times* 21 April, 9 August 1983; *The Guardian* 27 June 1985. [↑](#endnote-ref-32)
33. *The Guardian* 16 July 1984. [↑](#endnote-ref-33)
34. *The Guardian* 14 May 1985; *The Times* 14 May, 18 May 1985. [↑](#endnote-ref-34)
35. *The Guardian* 17 July, 29 July 1985; House of Commons Debates 16 July 1985 vol. 83, cc. 289-96. [↑](#endnote-ref-35)
36. Dixon had spent £6 million on a villa in the south of France, £1.7 million on investing in films, and had filched £1.6 million as petty cash. Other monies went into a diamond syndicate, a Spanish orange juice company, a yacht, an aeroplane and real estate, all charged to the PCW syndicates. *The Guardian* 13 November 1985. [↑](#endnote-ref-36)
37. *The Guardian* 14 January, 17 July 1986. Cameron-Webb died in California in 2004. [↑](#endnote-ref-37)
38. *The Economist* 29 June 1991. [↑](#endnote-ref-38)
39. *The Economist* 15 February 1992. [↑](#endnote-ref-39)
40. *The Guardian* 17 June 1988, 8 October 1991, 13 January 1992. [↑](#endnote-ref-40)
41. *The Guardian* 23 February 1990, 29 March, 3 September 1991; *The Economist* 19 October 1991. [↑](#endnote-ref-41)
42. Ironically the E&O policies had been purchased from other Lloyd’s syndicates, whose names included some of those involved in the Outhwaite suit, and who thus ended up paying for part of their own settlement. *The Economist* 15 February 1992; *The Guardian* 25 February 1992. [↑](#endnote-ref-42)
43. *The Economist* 26 January 1991. [↑](#endnote-ref-43)
44. *The Economist* 11 May 1991. [↑](#endnote-ref-44)
45. Southerst (1992). [↑](#endnote-ref-45)
46. *The Guardian* 22 October 1991, 3 April, 6 April 1992. [↑](#endnote-ref-46)
47. *The Economist* 17 October 1992. [↑](#endnote-ref-47)
48. *The Guardian* 13 April 1994. A year earlier the Serious Fraud Office had begun an investigation, but this was quickly aborted for unknown reasons. [↑](#endnote-ref-48)
49. *The Economist* 30 April 1994. Some found it ironic that the Gooda Walker defence lawyers called in Richard Outhwaite as their expert witness. [↑](#endnote-ref-49)
50. *The Guardian* 20 May 1994. [↑](#endnote-ref-50)
51. *The Economist*  8 October 1994. By a balanced book, Von Eicken meant (i) spreading risks and premiums over several classes of risk to limit exposure to a single event; (ii) estimating the most serious catastrophic loss that could afflict the portfolio, termed the ‘Probable Maximum Loss’ (PML); (iii) reinsuring up to the PML. This procedure, according to Von Eicken, should be followed by reinsurance underwriters for each year of account. [↑](#endnote-ref-51)
52. Phillips (1994). [↑](#endnote-ref-52)
53. For evidence that this concern was kept well hidden from newcomers entering the market see ‘The decline and fall of Lloyds of London’, *Time Europe Special Report*, 21 February 2000, [www.time.com/time/europe/lloydsfile](http://www.time.com/time/europe/lloydsfile), accessed 10 June 2011; Luessenhop (1995), pp.163-72. [↑](#endnote-ref-53)
54. *The Times* 27 August 1982. The leading Australian manufacturer of asbestos, James Hardie, experienced a seven-fold increase in legal actions 1983-89. Moerman et.al. (2014), 985-6. [↑](#endnote-ref-54)
55. *The Times* 28 August 1982. Average Turner & Newell settlements were only £600 per claimant. [↑](#endnote-ref-55)
56. The first inquest in the UK to cite asbestosis as a cause of death occurred in 1924.Turner & Newell established an asbestosis compensation fund for its workers in 1931, and the UK government launched a similar scheme that year. Tweedale and Jeremy (1999); Tweedale (2000). [↑](#endnote-ref-56)
57. *The Guardian* 15 January, 21 January 1991. [↑](#endnote-ref-57)
58. A full analysis of the effects of the spiral on individual syndicates was given by the Lloyd’s inquiry, chaired by Sir David Walker, Lloyd’s of London (1992). The spiral has been modelled econometrically by Bain (n.d.). [↑](#endnote-ref-58)
59. Luessenhop (1995), p.128. [↑](#endnote-ref-59)
60. Phillips (1994). [↑](#endnote-ref-60)
61. The total value of claims arising from the Piper Alpha disaster, including those on insurers, reinsurers and retrocedents, are said to have amounted to over ten times the insured loss. Lloyd’s of London (1992), para. 2.14. [↑](#endnote-ref-61)
62. Lloyd’s of London (1992), paras. 2.10, 2.19. [↑](#endnote-ref-62)
63. It had been 13 per cent in 1983, Lloyd’s of London (1992), para. 2.19. [↑](#endnote-ref-63)
64. Luessenhop (1995), p.129. [↑](#endnote-ref-64)
65. Luessenhop (1995), pp. 39, 64; Bain (n.d.), p.15; Lloyd’s of London (1992), para. 2.20. [↑](#endnote-ref-65)
66. *The Guardian* 14 February 1992; Luessenhop (1995), pp.121-2, 154-5. ‘Baby’ syndicates typically had a small number of names. For baby syndicates in the PCW scandal, see *The Guardian* 13 November 1985, and House of Commons Debates 16 July 1985 vol. 83, cc.289-96 (Gould)*.* Even while these scandals were being investigated Lloyd’s council decided against banning baby syndicates and opted for a voluntary code of practice, *The Guardian* 10 July 1985; Davison (1987), p. 144. [↑](#endnote-ref-66)
67. Lloyds of London (1992), para. 5.16; Southerst (1992). For further evidence of the skewed distribution of losses, see the data collected by the American Names Association on its website [www.truthaboutlloyds.com](http://www.truthaboutlloyds.com). [↑](#endnote-ref-67)
68. Luessenhop (1995), pp.26-7, 48-9, 72. [↑](#endnote-ref-68)
69. Lloyd’s of London (1992), para. 2.1. [↑](#endnote-ref-69)
70. All the LMX syndicates together accounted for over 60 per cent of Lloyd’s (negative) results in the accounting years 1988 and 1989. *Ibid*. [↑](#endnote-ref-70)
71. *The Times* 13 November 1985; *The Guardian* 12 November, 13 November, 20 December 1985; Davison (1987), pp. 2, 34-5, 155-7, 165-6. Davison’s resignation letter is reproduced in Davison (1987), appendix II. [↑](#endnote-ref-71)
72. The allusion was to Richard Brinsley Sheridan’s play, *The School for Scandal* (1777). House of Commons Debates 14 January 1986 vol. 89, cc. 974-7 (Mitchell), c. 949 (Smith). See also *The Guardian* 11 January 1986. [↑](#endnote-ref-72)
73. *Ibid*., c. 1015 (Howard). Neill was Vice-Chancellor of Oxford University and had chaired the Council for the Securities Industry from 1978 to 1985. [↑](#endnote-ref-73)
74. House of Commons Debates 12 June 1986 vol. 99, cc. 570-1 (Gould), 574-5 (Ashdown). [↑](#endnote-ref-74)
75. *The Guardian* 28 July 1986*.*  [↑](#endnote-ref-75)
76. On a private visit in 1991 Margaret Thatcher praised Lloyd’s as standing for the ‘very best business ethics and the very highest of standards…’, cited by Duguid (2014), p.72. [↑](#endnote-ref-76)
77. Lloyd’s of London (1987). Writing just after the Neill report was completed, Davison believed these reforms provided the solution to the problems at Lloyd’s. Davison (1987), pp. 189-92. [↑](#endnote-ref-77)
78. *The Economist*  11 December 1993. [↑](#endnote-ref-78)
79. *The Economist*  22 January 1994. [↑](#endnote-ref-79)
80. Luessenhop (1995), pp. 254-64. Rowland was head of the giant Sedgwick broking firm and a member of council. His nomination by Coleridge was denounced by angry names who demanded that the entire council resign. *The Guardian* 28 July 1992. [↑](#endnote-ref-80)
81. *The Economist*  4 July, 25 July 1992. [↑](#endnote-ref-81)
82. *The Guardian*  28 July 1992; *The Economist* 13 August 1994; Luessenhop (1995), p.254. Under Lloyd’s three year accounting system the profits of 1993 were not due to be paid out until 1996. [↑](#endnote-ref-82)
83. Coleridge had little sympathy for those in difficulty. He told a name in 1994 that ‘they went into a risk business, insurance isn’t selling baked beans’. Cited by Luessenhop (1995), p.78. [↑](#endnote-ref-83)
84. Luessenhop (1995), pp. 280-300. [↑](#endnote-ref-84)
85. Zinkewicz (1997). By 2012 only three per cent of capacity was still written on an unlimited liability basis. Duguid (2014), p. 292. [↑](#endnote-ref-85)
86. Dilks (1997). [↑](#endnote-ref-86)
87. Duguid (2014), p.12. [↑](#endnote-ref-87)
88. *The Economist* 10 December 1994; Goddard (1997); Duguid (2014), pp. 279-80. [↑](#endnote-ref-88)
89. Ninety-seven per cent of names accepted the settlement, though a substantial minority (23 per cent) of US names refused. Duguid (2014), pp. 281-8. [↑](#endnote-ref-89)
90. Duguid (2014), pp. 294-5. [↑](#endnote-ref-90)
91. Losses included a record £2bn from the 9/11 terrorist attack on the World Trade Centre. *Financial Times* 11 April 2002. [↑](#endnote-ref-91)
92. *Sigma* (2002), no.3, p.18. [↑](#endnote-ref-92)
93. *Financial Times* 28 November 2001. [↑](#endnote-ref-93)
94. *Lloyd’s Annual Report* 2012, pp.1-2. [↑](#endnote-ref-94)
95. Malcolm Gladwell has argued that contagion is a function of social context and is one of the factors that lead to a tipping point. Gladwell (2000), pp.139-40, 158. [↑](#endnote-ref-95)
96. *The Times* 14 May 1985. [↑](#endnote-ref-96)
97. In the early 1980s 73 per cent of applicants were being accepted for the short so-called ‘rota’ admission interview at Lloyd’s. Ninety-seven per cent of those interviewed were admitted. Calculated from Davison (1987), p.224 n4. On the rota interview and the seduction of ‘joining the club’, see Luessenhop (1995), pp.20-25, 32-3, and Duguid (2014), p.14. [↑](#endnote-ref-97)
98. By 1991 the top rate of UK personal income tax, which had reached 98 per cent in the 1970s, had fallen to 40 per cent, wiping out much of the tax advantage enjoyed earlier by Lloyd’s names. *The Economist* 9 March 1991. [↑](#endnote-ref-98)
99. Duguid (2014), pp.18-22. [↑](#endnote-ref-99)
100. Davison (1987), p.25; Duguid (2014), pp. 6-7; Browne (2010), slides 5-6. [↑](#endnote-ref-100)
101. Luessenhop (1995), p.28; Phillips (1994), pp.117-18; Berger, Cummins and Tennyson (1992). [↑](#endnote-ref-101)
102. On different types of knowledge, see Mokyr (2002), chapter 1. [↑](#endnote-ref-102)
103. Kahneman (2011). [↑](#endnote-ref-103)
104. *Ibid*., pp.7, 112-113 [↑](#endnote-ref-104)
105. Mokyr argues that economic and technological development can depend upon the constraints or incentives that institutions impose on different categories of knowledge in any given society. Mokyr (2002), pp.285-97. [↑](#endnote-ref-105)
106. Browne (2010), slide 7. [↑](#endnote-ref-106)
107. *Ibid*., slide 6. [↑](#endnote-ref-107)
108. Kahneman (2011), pp. 201, 240. [↑](#endnote-ref-108)
109. Kahneman (2011), pp. 237, 243; Hey, Lotito and Maffioletti (2010); [↑](#endnote-ref-109)
110. Karlsson, Loewenstein and Seppi (2009); Laury, McInnes and Swarthout (2009). [↑](#endnote-ref-110)
111. Kunreuther, Meszaros, Hogarth and Spranca (1995); Kunreuther, Novemsky and Kahneman (2001). [↑](#endnote-ref-111)
112. Kahneman (2011), pp. 218-21, 234-44, 252, 255-7, 263; Syed (2015), p.109. [↑](#endnote-ref-112)
113. Taleb (2007), pp. 58, 61, 149-51; Angner (2006); Ashiya and Doi (2001); Bewley and Fiebig (2002). [↑](#endnote-ref-113)
114. Taleb (2007). [↑](#endnote-ref-114)
115. Gillian Tett, for instance, has questioned the expertise of those involved in the slicing, repackaging and selling mortgage default risk, a business with similarities to XL reinsurance, in the years before the crisis. Tett (2009), pp.113-17, 149, 244. [↑](#endnote-ref-115)