Independent View

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30 years of change at Lloyd's

Thomas Ward, Private Client Director at Hampden Agencies explains why he believes the changes Lloyd's has undergone have resulted in the best investing conditions for a generation.

Lloyd's has overcome many challenges since the first deals were struck in Edward Lloyd's coffee shop in the late 1600s, and the last, most infamous of these was in the late 1980s.

Fast forward 30 years and following a complete reconstruction of the market, 2024 sees us entering the sixth year of continual rate rises and the current market figures look extremely promising, with 2021 at 12%, 2022 at 18% and 2023 currently forecast for a 23% return on capital[1]. In the three decades since Lloyd's worst years, the market has undergone a major transformation, leaving it in a much stronger position today than at any other point in history.

To understand how these changes have advanced the world's leading insurance and reinsurance market to put us in the position we are now, we can't overlook the past, so let's start some 50 years ago. During the 1970s and into the 1980s, liability claims arising from asbestos and corporate environmental claims in the litigious United States were followed by the unrelated but parallel insured tragedies of Piper Alpha and Exxon Valdez. They put huge pressure on what was then a less regulated and still less well-run Lloyd's market.

This series of liability and catastrophe claims unearthed what was a critical vulnerability of the Lloyd's market. Many syndicates who underwrote the risks brought to Lloyd's had participated in so-called 'excess of loss' reinsurance, which covered losses of other Lloyd's syndicates over a certain level. This type of reinsurance had worked well for decades and the London Market Excess of Loss (LMX) product was popular for syndicates and members because it was initially profitable for most. The profits, however, hid the true issue, in that no one knew just how interconnected the LMX had become until it was too late. At that time, private investors at Lloyd's (known as Lloyd's Names), who provided capital to the syndicates, had unlimited liability and the combination of structural and operational factors reached unsustainable levels for many of these individuals.

Lloyd's had no choice but to change. So, throughout the 1990s, Lloyd's looked to rebuild itself. New capital rules were introduced, along with more oversight and professionalisation.

Under the leadership of a new CEO, David Rowland, Lloyd's recognised the need to reform and the new Lloyd's Market Board (LMB) replaced the old Committee of Lloyd's. A new Lloyd's Regulatory Board (LRB) was also set up to better regulate the market.

In 1996 Lloyd's published their 'Reconstruction and Renewal' plan, which introduced a wide range of market reforms. As part of these changes, Lloyd's no longer permitted new members to have unlimited liability, but insisted that new members join through limited liability companies. This was later widened to include partnerships (LLVs). When structured as a partnership or shareholding of a limited liability company, the risk of unlimited liability that Names had dealt with for generations was removed, ensuring that only those assets used to underwrite at Lloyd's could ever be at risk. This also provided investors with financial certainty.

[1](figures from Hampden Underwriting Research (HUR) team based on Lloyd's 2023 Q3 syndicate forecasts and spot estimates released to HUR by syndicates in Q4 2023).

A key pillar of this plan removed historical liabilities, making the market more attractive for new members and corporate capital. The plan also helped clarify to all stakeholders that Lloyd's was finally drawing a clear line under its past mistakes. The result of a decade of work in improving the market came to the fore in 2002, when authority was given to Lloyd's for the creation of a Franchise Board and Franchise Performance Directorate. Starting on 1st Jan 2003 it brought about a tougher, more coherently managed market, wielding executive control of syndicates' business plans, setting risk guidelines and targeting the poorer-performing classes of business and syndicates.

A good illustration of the impact of these changes was during the hurricane years of 2004 and 2005 when the US was hit by a series of major hurricanes, culminating in Hurricane Katrina. Katrina remains the most expensive single storm for the insurance industry of all time, at US$150bn. In comparison, the 30-year average annual loss for all types of natural disasters is US$56bn.Even so, Lloyd's remained profitable over this period, indeed investors through Hampden on average made 13.9% on their capital deployed (5.6% on capacity underwritten). This was due to a hard market, with high insurance rates ensuring a very profitable period that lasted until 2017. Higher than expected claims in 2017 and 2018 and Covid losses affecting 2019 and 2020 have pushed insurance rates back up to the highest seen for a generation.

With a healthy change to the market's operations since 1996 and AA ratings from S&P and Fitch, Lloyd's is looking in good shape. One of the reasons syndicates like private capital to support their underwriting is that it is 'sticky' – in other words, loyal over a length of time, and the market improvements made in the past two decades have helped enforce that thought. On the same period, investors via Hampden have recorded an average annual internal rate of return[2] of 17% per year.

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Investors can use existing assets such as equities and bonds as their funds lodged at Lloyds (known as FAL), and can continue to receive the income from these assets while also generating insurance returns. It is this double use of assets and the potential for double profits from them, that really enhance the appeal of Lloyd's.

For UK taxpayers there are additional potential inheritance tax benefits and business reliefs, which can fit into, and work well with, a family financial structure and family succession planning.

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[2](IRR is based on the subset of clients continually investing via Hampden between 2003-2022)