

FINANCE

Mountains still to climb

If April's business plan for Lloyd's does not satisfy both its capital providers and its clients, the market could die

ONE peak scaled often reveals another. So it is at Lloyd's, London's insurance market. Last year was awful: the market reported losses of over £2 billion (\$3.3 billion) for 1989, lawsuits alleging negligence mushroomed, and names (the individuals who provide Lloyd's capital) were outraged by a levy to boost central funds. But some said the worst was over. Losses for 1990 would be smaller; as the insurance cycle turned, later years would bring profits. And the new management team of David Rowland as chairman and Peter Middleton as chief executive would improve market efficiency and placate angry names.

Such optimism now seems premature. It has become clear that the market's loss for 1990, to be announced in June, will be bigger than that for 1989, probably close to £3 billion. Admittedly, a chunk of this—possibly £500m-1 billion—is a form of double-counting, for it represents stop-loss payments to names who made losses in 1989 and syndicates' "errors and omissions" (E&O) reserving against names' lawsuits. Both of these involve payments by one lot of names to another, not a net market loss. But the money still has to be found. And whereas 1989's losses were concentrated on the 5,000 names in excess-of-loss catastrophe syndicates, the 1990 losses will be more widely spread; few names will avoid them.

The cumulative effect of huge losses is undermining the market. As names resign or go bust, Lloyd's capacity has shrunk. The market now has just under 20,000 active names with an underwriting capacity of £8.75 billion, down by 40% in real terms from 1988. Names who struggled to pay 1989's losses last year will find it even harder to meet 1990's. And most are trapped in "open years"—syndicate years with losses that are too big and unpredictable to be closed by reinsuring into a successor year. Already 84% of names have at least one open year; by June that figure will be close to 100%. Members with open years can stop underwriting, but they cannot leave Lloyd's.

It is an inauspicious background for Lloyd's first-ever business plan, which will be unveiled by Messrs Rowland and Mid-

dleton in late April. The plan, which will set Lloyd's future course, is now being discussed by its market board. According to Mr Middleton, its proposals could be more radical than the reforms suggested in last year's taskforce report—partly because the huge losses revealed since then have softened resistance to change. Cost-cutting, for instance, is being stepped up. Lloyd's is sacking central staff; agencies are following suit.

Mr Middleton thinks he can push through reforms, even though the members' agencies that look after names and the managing agencies that run syndicates are fiercely independent. The centre may exert some control because the agencies all trade under its brand-name. He wants to raise professional standards, and to make economies through amalgamation and centralisation of some functions, including those now spread among 80 members' agencies. He is also keen on corporate members, both to help the market grow and to spur higher underwriting standards.

Most of this will be welcomed by names. But it leaves three other big problems: open years, litigation and financing the 1990 losses. The main reason that these are so tricky is that they all involve huge sums of money.

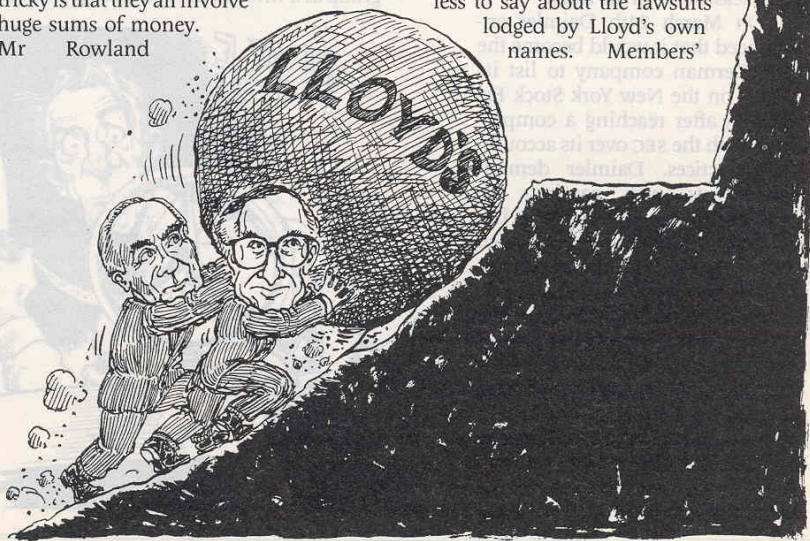
Mr Rowland

likes to say that he has no magic lamp to rub which can produce money from thin air.

The business plan will certainly discuss open years; it has to, for finding an exit route has become most names' top priority. The plan may suggest a bigger job for Centrewrite, the Lloyd's-owned insurance company set up in 1991 to offer quotes to syndicates unable to close their accounts. But Centrewrite will need a lot more capital from the market if it is to cope with the hangover of past claims, especially those arising from American asbestosis and pollution for which insurers are contesting liability in court. And names who are relatively free of these burdens will protest against any tacit mutualisation of losses.

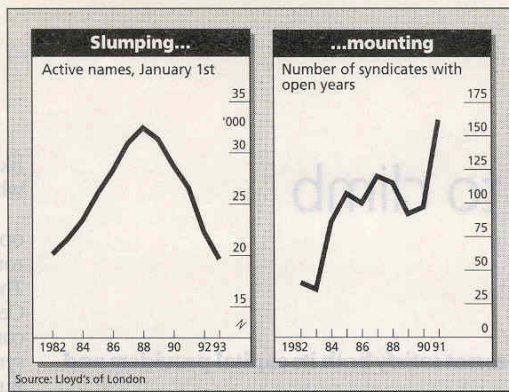
Those with an eye to the future say that Lloyd's must insulate newcomers from the cost of the past—otherwise nobody, individual or incorporated, will join. Some have suggested leaving all 1990 accounts open, for instance, thus ensuring that no claim from that year or earlier ones falls on future names. By showing that capital-providers can find the exit blocked, however, such a move could deter new names from signing up. Mr Middleton sees a case for concentrating old-year claims and reserves in a single body, to present a united front to claimants. But that may not do much to close years that are open because insurers are fighting policy-holders or their successors through American courts (although some recent decisions have been helpful to Lloyd's).

The business plan will have less to say about the lawsuits lodged by Lloyd's own names. Members'



and managing agencies have been deluged by writs from angry names convinced that they are the victims of negligence rather than bad luck. Mr Middleton points out that, if prospective litigants could settle with the E&O insurers who would have to pay whenever claimants won, it would minimise the sums siphoned off by lawyers. But the insurers are not keen to settle on the names' terms. Not all the claims are equally strong; many E&O insurers have reinsurance outside Lloyd's that they can claim on only if they lose in court; and the E&O pot of about £1 billion is anyway too small to cover all litigants.

Letting the litigation run is dangerous, however. It means at least three years of bad publicity for Lloyd's, which might put off not only new names but also new policyholders. It could drive many agencies into bankruptcy. Some names reckon that, despite its immunity from most lawsuits under the 1982 act, Lloyd's itself could be held liable if it were shown to have acted in bad faith. If they are right, that could close down the whole market. Hence, the angry names



argue, the case for a generous settlement now, drawing not only on the reserves set aside by E&O insurers but also on borrowing through a bond issue by Lloyd's.

A bond issue is also talked of as a possible solution for the third problem, financing 1990's losses—which the business plan may not even discuss. Rising insurance rates should make the early 1990s profitable. But names cannot touch those profits for another three years, under Lloyd's system of

back-dated accounting; meanwhile, they must meet losses for 1990 (and perhaps 1991).

Mr Middleton would like to help those who want to continue underwriting. But any borrowing to pay for past losses could run foul of the trade department's solvency rules (though some see the Treasury's modest budget measures to help names build reserves as a sign of government sympathy). Mortgaging future profits would make the market less attractive to new capital. And profits may not, in the event, materialise; few people expected the New York bomb or America's recent storms.

Names, policy-holders and prospective investors are pinning a lot of hope on the Rowland/Middleton business plan for Lloyd's. The two men win plaudits for their willingness to listen to both suggestions and grievances. But good intentions are not enough. If the plan cannot solve the open-year problem, help head off litigation and find a way of meeting 1990's losses, Lloyd's may not survive. The stakes are that high.

Daimler plays ball

BERLIN

"THEY want to play baseball in America, but they want seven strikes, no umpire and a right to cancel the game." So said the chief of America's Securities and Exchange Commission (SEC), Richard Breeden, of German companies that want to list shares in America without disclosing their financial condition as American companies do. Daimler-Benz, one of the chief targets of Mr Breeden's scorn, has now agreed to play by at least some of his rules.

On March 24th Daimler announced that it would become the first German company to list its shares on the New York Stock Exchange, after reaching a compromise with the SEC over its accounting practices. Daimler demonstrated its new candour by revealing DM4 billion (\$2.5 billion) of its hidden reserves, which the company will declare as extraordinary profit for 1992.

Just how far this candour will go is unclear. Neither Daimler nor the SEC has revealed details of their agreement; Mr Breeden is to wrap up the deal with Daimler's chief financial officer next week. If Daimler were to adopt American standards fully, it would abandon the conservatism for which German

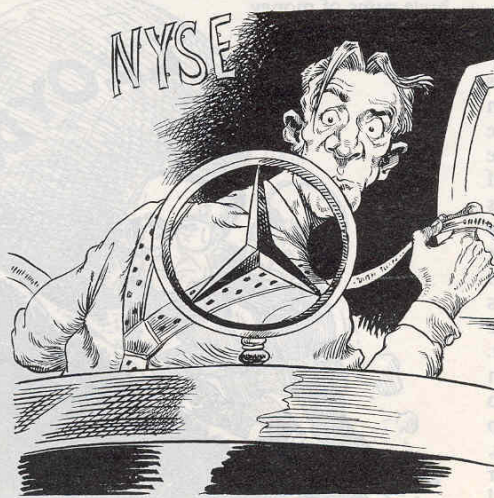
companies are notorious and would present its accounts to suit shareholders rather than creditors.

Under an American regime, Daimler would disclose its financial results quarterly, by division. It currently makes no quarterly disclosure of earnings and reveals divisional results only yearly. Because the accounting methods it applies to its subsidiaries are not uniform, their combined results differ from those of the group as a whole. That will change. Daim-

ler would also have less scope to hide profits through unidentified provisions. And it might use less-conservative depreciation schedules, which would fatten its reported profits.

Daimler's reward for disrobing will be better access to the capital of American investors. The company called off a DM2 billion rights issue last year when its share price plunged. It may find the New York listing helpful in returning to the market. Michael Geiger, an analyst at NatWest Securities in London, is sceptical about this, however. He argues that Daimler's share price is still too low (about half its peak of DM1,200) and that Daimler's complicated ownership structure will prevent the company from raising capital soon. He speculates instead that Deutsche Bank will take advantage of increased American interest to unload some of its 28% stake in Daimler.

Daimler's deal with the SEC could be the biggest break so far with Germany's shareholder-unfriendly style of capitalism. German companies have recently faced growing pressure from their owners, especially foreign ones, to disclose more information and to manage in the interests of investors. Daimler now seems prepared to give its shareholders a better deal. If other big companies follow Daimler's lead, German capitalism may never be the same again.





Visual 1: Unemployment - Little shop of horrors plant (*The Economist*, April 25th 1992, p57).