A Lloyd's Brokers Historical Perspective

Good morning ladies, gentlemen and Retail Brokers

This is an intimate gathering, but as one of my clients said to a Lloyd's Underwriter 'everything's big in Texas, especially the Claims'.

When preparing this form of presentation you are faced with two simple choices. A short amusing oracle with lots of witticisms and ad libbing or a long boring prepared speech like this one.

It was a story about the late President Theodore Roosevelt that helped me decide to make a long and prepared speech.

It seems he left his hotel in a hurry on the night of 4th October 1912 to make a campaign speech in Milwaukee. Apparently, he always prepared a 'short' and 'long' version whenever he was scheduled to make a speech. Leaving it to the last minute to decide which to use, depending upon his mood. At the last minute on this fateful night he picked up his long, thick and extended version, folded it in three, pushed it into the inside pocket of his jacket and left the hotel in haste.

En route to his destination Theodore Roosevelt was shot in the chest at point blank range. Interestingly enough, not being one to give up, he went on and ad libbed a different speech about health care.

Later on, in hospital, the folded speech and his spectacle case were found to have a "dime" sized hole in them. It seems they had combined to slow down the bullet sufficiently to save his life. I hope **I** won't need such protection in Houston.

When discussing Lloyd's Brokers today I shall be concentrating my observations on our role as placers of Direct Energy Business into the Lloyd's and London Company Markets. I emphasize this cannot be a precise history of events but this is 'how it seems to me'.

I have named this presentation "A View from the Queue" as 50% of our time is spent queuing to see Underwriters in the Room at Lloyd's - an antiquated system without doubt, but one that has survived the last 300 years.

The Planning Committee has kindly invited me to talk to you about how life has changed in our profession over the last century. I hope I don't have to make it clear that I haven't been around for the past 100 years. Unfortunately, it does seem that I maybe the oldest if not the wisest surviving Lloyd's Broker.

My message to you all today is that, notwithstanding all the changes that have taken place, this is still a people business.

How do you define a 'Lloyd's Broker'. I have sought much advice on this question and the best definition I have heard so far is 'These people are capable of watching an entire episode of "The Walton Family" without crying'.

I am often asked 'how do you become a Lloyd's Broker?' I have only ever met one of our profession whose ambition from his schooldays was to be a Lloyd's broker - and his name is Lloyd!

We arrived at Lloyd's as Brokers by varying routes. Some failed their Law Degrees, some found Accounting too dull but the majority of us, like myself, arrived in this, one of the oldest professions, by accident. My case is not typical but nevertheless representative of how young intellects such as myself became Lloyd's Brokers.

I was expelled from school at 15 years of age. My father put me on the train to London and told me not to come back without a job! I had no qualifications but by the end of that day I had two job offers, one as a Solicitor's Clerk and one as a Tea Boy/Filing Clerk in a Lloyd's Broking House. The rest, as they say, is history. This took place a month before the school summer term ended. A month later the world descended upon the City of London looking for jobs when many of my better qualified friends found all positions taken up. If I had joined "the pack" my chances of obtaining gainful employment would have been drastically reduced. I am living evidence that it pays to be lucky rather than clever.

Today that would not be possible. You would need Advanced level GCSE qualifications and/or a University Degree if you were to join a Broking House at a level, which offered a future. Whereas I took my first professional examinations when I was 25 years old, 10 years after I started work. I still wake at nights worrying about the Association of Chartered Insurance Institute Marine Law paper, which at the time had a pass rate of below 25%.

I have to be careful what I say about Lloyd's as I am joined on this platform by Barnabus Hurst Bannister, a very distinguished and influential speaker from that Market **(at least that's what it says here).**

To discuss the Lloyd's marketplace is not my brief here today but some background from a Broker's viewpoint may be helpful. Until the 1960's Lloyd's Syndicates were traditionally sole traders, representing groups of individual investors or syndicates, as they are known. These were often family businesses passed down from Father to Son. Making a profit, with one or two exceptions, was taken for granted. Business was traditionally Marine. Non-Marine Underwriters were hidden away upstairs. In those days Lloyd's Underwriters could only accept business through a Lloyd's Broker but in some sectors of business this is no longer the case.

Much of this changed in the Sixties. Rating levels and underwriting disciplines were in decline and losses such as the Salad Oil Fraud, Hurricane Betsy and Computer Leasing Indemnity brought about an awareness that underwriting losses were a reality.

This ultimately created a more outward looking society and simultaneously more demand for new ideas from Lloyd's Brokers who are the Lloyd's marketing force. Brokers realised there were opportunities in this new world beyond their traditional Marine sources of business.

Lloyd's Brokers returned from North America and the Far East with Non Marine Property and Casualty business both as direct or by way of reinsurance. Brokers such as Bland Welch produced large amounts of new North American Property business to London. Energy business became more specialised in order to deal with the capacity demands brought about by rising Platform and Rig Values, North Sea Exploration costs and the need to provide higher Third Party Liability limits for clients located in North America (to be regretted by Names later). Failure to keep pace with demand, specifically pollution, in terms of coverage and limits led to the Oil companies developing their own solution by the establishment of the highly successful Oil Insurance Limited on 15th December 1971. O.I.L. now has more than 40 mutual members.

By way of coincidence, the next underwriting crisis of the late 80s /early 90s was also brought about by three triggers - Piper Alpha, Long Tail Liability Claims (being a consequence of Asbestosis and Pollution) and the much anticipated LMX spiral.

There is a shortage of recorded history concerning Lloyd's Brokers. I quote from Lloyd's records 'The normal method of insuring a ship in the 17th Century was for the Broker - often referred to as 'an Insurance Office Keeper' to take a policy round the City for subscription by wealthy merchants, men of substance, who would be able to meet their share of a claim to the full extent of their personal fortunes, if need be".

I am fascinated by this earliest reference to a Lloyd's Broker being known as Insurance Office Keeper some may suggest that Poacher would have been a more appropriate description.

In the same way that magicians never reveal their secrets, brokers never divulge their favourite tactics. For example, the casual observer may note that all the truly great brokers of our time wear spectacles.

There is not a statistical anomaly that shows that brokers as a group are visually impaired. The truth is more sinister!

Watch carefully and you will witness an Oscar winning performance as the underwriter inevitably asks the one question that the broker either doesn't want, or expect. Suddenly the glasses are off, on the floor and quite deliberately trodden on. This performance will be followed by a major clean up operation and by the time all is well the conversation will inevitably have moved on. One practitioner has a bottom draw full of straight lens glasses.

Another broker never went into the Market until after 5 o'clock, when the Underwriters were getting weary and wanting to get home. He was known as 'deadly nightshade'.

In the time available it is impossible for me to go into a full list of the changes that have taken place, so I have chosen some of my favourites.

? (Slide 2)

I have selected these five areas of Changes to our Business to explore.

- Brokers

- Underwriters
- Clients
- Technology
- Titles

Let us deal with Brokers first of all.

? *(Slide 3)*

As this is my area of expertise, I have selected **Six Changes that have affected Lloyd's Brokers**:

- Relationships
- Standards
- Qualifications
- Efficiency
- Entertaining
- Regulation

? ***(Slide 4)*** Relationships

We act either directly for a Client or for a Retail Broker. Sometimes a Surplus Line Agency, such as J H Blades & Co produces business to us on behalf of Retailers. These "Cover-holders" tend to have their own Broker placed facilities with specialist underwriters for certain classes of business.

In the past there has been healthy cross pollination and open competition between US based retailers and Lloyd's Brokers. However this has changed because in many cases Lloyd's Brokers and Retailers are now jointly owned.

? *(Slide 5)*

Let us examine how these Broker Relationships have changed.

In the early 1980s, my estimate is that there were:

- **?** 17 Independent US Energy Retail Brokers
- **?** 21 Independent Energy Lloyd's Brokers
- **?** Producing 357 Combinations of Choice

? *(Slide 6)*

In 1999 the picture has changed, I estimate there are:

- **?** 8 Independent US Energy Retail Brokers
- **?** 7 Independent Energy Lloyd's Brokers
- **?** Producing 56 Broker Combination Choices
- **?** An 85% Reduction in Choice

? *(Slide 7)*

Broker Relationships

What does this loss of choice mean?

- ? ***(Slide 8)*** Conflicts of Interest

  With so few specialist brokers available, clients are concerned that it is no longer possible for a broker to be 'exclusive'. This may mean a broker will often have to serve two or more clients competing on the same project.

- ? ***(Slide 9)*** Restricted Tenders

If clients restrict bid invitations to brokers with revenues greater than $4 billion there can only be two bidders.

? ***(Slide 10)***

This slide shows how Commission Revenues of the World 10 largest brokers are shared. Aon and Marsh have a market share of 74%. No other broker reaches a double digit share. Is there an equivalent imbalance in any other global industry?

- **? *(Slide 11)*** Market Pressure

With over two thirds of premium revenue controlled by two brokers, commercial pressure must play a part in the market. Is this what the client wants? Surely you want your Insurer to be a willing partner in your venture. Do clients really want to partner with Insurers who have been forced to participate for Commercial & Market share reasons? I think not, after all clients will only really need to call on their Underwriters when they are in trouble.

- **? *(Slide 12)*** Biggest or Best?

There is a danger that the Big Two can be viewed as the Premier League. These firms undoubtedly employ some first class people but biggest doesn't always mean the best. Niche companies will always explore "another way of doing it". To put it another way, can only the best people in Aon and Marsh handle the majority of the world's business?

I believe there is room for others to excel, especially niche brokers, as evidenced by our own Company which has attracted over 150 new clients in its first 18 months of existence as a Natural Resource Broker.

? *(Slide 13)*

Moving on to Standards of Lloyd's Brokers

One of the attractions of being a Lloyd's broker is the camaraderie that exists between the individuals in the Market Place, not just those in your own Company. I know this sometimes makes our US Retail friends nervous.

I am sad to say however that the behaviour of some Lloyd's Brokers today does leave a lot to be desired. The problem stems from a basic lack of understanding of the Law of Agency. Here are 2 examples.

i) Market Blocking.

> All Brokers, even me, lose business to competitors. It is not necessarily your fault but when you are replaced you no longer represent the Client. But that does not give you licence to go out and actively block the progress of the new broker by way of threats and innuendoes to Underwriters. This is a very undesirable trend of the 90s and I wish Underwriters would report these activities to the principal Client.

ii) Brokerage

> Much has been written in the press on this subject and I simply do not understand why Brokers think it is acceptable to earn secret commission. If you're worth what you charge then Clients will pay. Deceit is not necessary and we do not allow it in our firm. What is wrong with transparency? The idea that Brokers are making a concession by disclosing earnings would be amusing if it did not in itself underline the problem. A solution could be that policies should not just show the Gross Premium (i.e. what the Client pays) but also the Net Premium (being what the Underwriter gets). This way acquisition costs become transparent to all parties engaged in the transaction.

? ***(Slide 14)*** Qualifications

I have already touched on this. Rightly, you cannot broke in Lloyd's today without, as a minimum, having passed the Lloyd's Test. It is not possible to register as an Insurance Broker in the UK without having passed your Insurance Examinations and /or an equivalent. Directors of Lloyd's Brokers need to have the appropriate qualifications or benefit from Grandfathering agreements. There are a lot of talented 30 year old Brokers in the Market today who will never become Directors of their Companies because, good as they may be, they lack professional qualifications. Compare this to the 1960s when any one could walk into a Broking House and go broking the very next day.

? ***(Slide 15)*** Efficiency

Our market is more efficient now than ever before. Money moves more efficiently, and the industry is more aware of the importance of cash flow. I contrast this with an experience I enjoyed during my first visit to Houston in 1974 when it was not possible to fly direct from London to Houston. I recall flying to Miami and spending another day working my way west to what has become a second home to me, thanks to Texan hospitality.

At that time, our accounts department in C T Bowring were complaining that cash flow from J H Blades was a problem. **John Molbeck (now President of Houston Casualty Company) was financial controller of Blades at that time. I explained my dilemma to John and he advised me that monthly payment cheques were indeed regularly mailed on time each month in accordance with the terms of the contract. Further enquiry in Houston showed me that these cheques were indeed being sent at the contracted time but by sea-mail which took 6 weeks to cross the Atlantic.**

We are now able to access IBA accounts and transfer funds at the press of a button, however this is a two edged sword as direct access to the Accounting Ledgers on computer screens does provide the opportunity for Executive control of cash never available to our predecessors.

? ***(Slide 16)*** Entertaining

Lavish entertaining as enjoyed in the 80s is over. Drinking at lunchtime (with one or two notable exceptions) is a thing of the past. Coincidentally, a few years ago the Tax Authorities in the UK disallowed Entertaining Costs for Corporation Tax relief. I am sure this timing is coincidental.

Everyone is margin conscious. Most of us have moved to the back of the aeroplane **-** in the 1980s a 40% Margin (Profit expressed as a percentage of Revenue) was considered par for the course, today 25% is a more realistic target as brokerage revenues have fallen. I exclude Reinsurance Broking Companies from this equation. For some reason, as a reward for not having to serve any direct clients or produce any direct business in at the front end of Lloyd's, they get paid a standard brokerage of 10% compared to 5% for us Direct Brokers.

? ***(Slide 17)*** Regulation

This is an important area at the present time.

Lloyd's Brokers are currently regulated by Lloyd's and the Insurance Brokers Registration Council in the United Kingdom. As I have mentioned previously, Lloyd's requires minimum levels of professional qualifications, annual audits, high levels of capitalisation and Errors and Omissions Insurance. Lloyd's Brokers are also required to abide by a Code of Practice. Lloyd's and its Brokers have always enjoyed a very special relationship because of these ties.

By way of example, during the Lloyd's Renewal and Reconstruction process, which began in 1995, the Lloyd's Broking community agreed to contribute up to £100 million to assist Lloyd's in resolving its problems. This caused Brokers some difficulty both financially and in our relationships with Insurance Companies who naturally asked if they would be treated equally. These payments expire in June 2000. Lloyd's will be free to abandon its traditional distribution routes in the year 2001, if it wishes.

It seems Lloyd's will almost certainly hand-over its Broker Regulation role to a newly formed General Insurance Standards Council who will regulate all Insurance Businesses trading in the United Kingdom. This new body will be an industry developed system of self regulation encompassing all Brokers and Insurers with effect from 1st January 2000. Initially it will deal with Non-Broker Intermediaries, possibly taking on Lloyd's Brokers in the middle of 2000 and all others at the end of the year.

When this happens it seems that the class of intermediary known as the Lloyd's Broker may be lost and any Broker approved by the GISC may be welcomed into Lloyd's. It may be that GISC introduces tier levels of regulation but nothing is for sure at the moment. Outside of the United Kingdom, Lloyd's may be trading Direct with providers of business, even U.S. Retailers. What a confusion that could cause. Who will regulate these overseas producers?

Make no mistake, these proposed changes will make a substantial difference to our business as we go forward. To put this into a UK context, in 1997 there were over 9,000 registered Insurance Brokers and Intermediaries, of which only 201 were Lloyd's Brokers.

We are very much in a minority within our country's own industrial group. Nevertheless, we do consider ourselves to be exclusive. Not for any reason other than the recognition that we have been accepted from a financial, administrative and professional perspective. To pass these stringent examinations on a regular basis is an achievement in itself and I believe having set the standard we wish to maintain it.

It is essential, however, that we have a level playing field on which to compete. I estimate that 15% of our company's costs are directly related to meeting regulatory standards.

There are, after all, at the last count, only 145 Lloyd's Brokers, a 46% reduction during the last 25 years.

I apologise for describing everything in terms of a percentage reduction, but these soft market disciplines are habit forming.

That is the story so far as Brokers are concerned.

? *(Slide 18)*

Let's move on to <u>Changes within the Underwriting Community</u>

In my view, underwriting is and always has been a question of greed overcoming fear. Today, however, if an Underwriter says 'No' it is just as likely to be for the reason that "the account doesn't fit my Reinsurance Programme" than anything to do with the inherent risk. Clients have problems in understanding why prices fluctuate from one year to the next when their underlying exposures are the same.

Apart from Underwriters appearing to be a lot younger, the main difference is that we now have lady Underwriters. There is a story concerning a young Total Loss Only broker who on his first visit to a lady Underwriter said 'you're A1'. The lady concerned was initially flattered and happily wrote a line on all slips offered but needing reassurance she asked precisely what the young Broker had meant by his opening remark. 'Well", he said, "if Bo Derek's a 10, you're a 1'. Not quite the response she was hoping for!

One aftermath of Hurricane Betsy was the formation of the Rig Committee followed by the placement of the Master Rig Slip by Sedgwick and Bland Welch. By 1978 this facility was shared by most of the major London Energy Brokers as it could provide limits of a $billion on the agreement of six leaders. These leaders were not common to all Brokers as each Broking House had its favoured underwriters. This in some cases led to a phenomena known as Underwriting by Committee.

One massive improvement in underwriting today is that apart from one or two very rare occasions we don't have the dubious benefits offered by such Underwriting Committees. Can you imagine in the 70s having broked your leader, he would then call a Rig Committee meeting in order to 'endorse' his thoughts. The two of you (sometimes the Leading Underwriter only) would have to broke the Committee. Needless to say, you never got the right answer.

The Master Rig Slip died off by the early 1990s as Underwriters preferred to select which risks to write or decline individually and Brokers sought independence away from the markets accepted leaders. Brokers therefore reverted to a combination of open market slips or specifically designed line slips or energisers as they were frequently branded.

It would be remiss of me not to make reference to how Lloyd's Syndicates or Managing Agencies have moved their ownership away from brokers to self ownership and then onto ownership by major insurers and capital providers. This in itself changes the nature of much of Lloyd's capacity from unlimited individuals to limited corporate investors. Inevitably this change has presented brokers with a different challenge as today 60% of Lloyd's capacity is provided by corporate limited liability investors. The evolution of the 'long term policy' is in my view a direct result of Corporate Investors wishing to secure their client base for longer than a year. In 1997 it was estimated by the Energy Market Leaders that 40% of their business was placed on long term policies.

Another challenge we now have is what is known as the Houston Syndrome. Can you imagine how it feels when after nurturing a market in Lloyd's over the years you are told that "we can't write this as our Houston office have already declined it". By way of comparison, if this risk had already been declined to another broker in Lloyd's the 'unacceptable' terms would be a matter of record and an indepth discussion and negotiation could take place.

Now it seems if Houston say ‘No’, that’s it. This is a trend I do not understand and I cannot help feeling that it will lead to trouble for everyone concerned.

There is a substantial amount of Underwriting capacity available today but we should remember it is now in fewer hands.

? *(Slide 19)*

This slide shows how the <u>London Market was constructed in 1975</u>

It shows that number of Lloyd’s Syndicates and the Lloyd’s Underwriting Capacity during that year. You will also note the average capacity of a Lloyd’s Syndicate was £4.4 million. The ILU don’t provide their capacity statistics but I have shown the number of their Members that existed in 1975. You will see these markets alone provided 434 separate underwriting units.

? *(Slide 20)*

This is an update of the previous slide showing 1999 numbers. The total number of Underwriting Units in these markets alone has reduced from 434 to 185. This represents a 57% reduction in the number of underwriting units. Another point of interest is the average capacity of a Lloyd’s Syndicate which has increased from £4.4 million to £71.51 million over the 24 year period. A similar study of Scandinavian Marine Insurers would show an even more dramatic reduction in terms of individual underwriting units.

What does all this mean? Well, in my opinion, when the Market does turn, as it surely must, it will be even less flexible than before. On the positive side, however, Lloyd’s has managed to retain a substantial element of its individual underwriting and decision making on a face to face basis which remains one of its strengths. It is worth mentioning that many other major insurers are moving towards this method of doing business. The establishment of the London Underwriting Centre being a good example.

? *(Slide 21)*

Let’s not forget our <u>Clients</u>

Risk Managers are more accountable to their CFO’s these days and clients find it hard to deal with the intense levels of Mergers and Acquisitions taking place in the Broking community. They complain there is no continuity in their Broking Team from one year to another because of continuing personnel changes. I sympathise very much with these frustrations but our industry could not continue to sustain the number of Lloyd’s Brokers that existed 10 years ago, especially the middle to large sized companies. Change had to happen but no one could have predicted the scale or the speed at which changes have taken place.

This is a changing world where our client base demands we keep pace with change and understand their business as much as we understand our own.

? *(Slide 22)*

<u>Technology</u>

I.T. has been of tremendous value and has replaced the traditional Quill Pen image of London. **I remember when C T Bowring purchased the first computer in the London Broking Community it was so large it had to be flown in by helicopter and dropped in through the roof of the fourth floor of the Bowring Building. I understand the capabilities of that machine were less than a PC costing US$2,000 today.**

Computers, e-mail, faxes have replaced typewriters and telexes. The long term cost savings have been enormous. **There is a story about the Chairman of one Lloyd’s Broking house who was receiving a presentation from an I.T. Sales Representative. At the end of the presentation the Chairman of the Lloyd’s Broking House asked ‘What exactly will this machine do for me?’. As quick as a flash the Salesman answered ‘Sir, it will <u>halve</u> the size of your accounts department’. ‘In that case’, responded the Chairman, ‘I’ll have two’.**

To our credit, as an industry, we have used I.T. as a very useful tool rather than let it rule us. However, I believe there will always be a place for the eye to eye negotiation. If we broke by e-mail the flavour of the discussion will be missing. Where will the next generation of Brokers learn their trade - for example, if it is on a screen, how will they learn to judge whether this is the time to go back to the office and wait for another day?

? *(Slide23)*

<u>Titles</u>

Another change is the proliferation of Titles in our Industry. It is truly amazing how these titles have evolved. For example, in London we have:-

Assistant Directors

Associate Directors

Executive Directors

Divisional Directors

Managing Directors (one Broker had 40 of these at the last count)

Chairman

Deputy Chairman

Chief Executive

How is a Client or Underwriter supposed to understand what authority comes with what title?

There should be a Broking industry standard in order to help clients and underwriters understand the authority of the person they are dealing with.

There are discussions taking place at the moment between the General Insurance Standards Council and the Chartered Insurance Institute to introduce a new title in the UK. This will be the Chartered Insurance Broker. If rumours are correct, only those brokers who have passed the Chartered Insurance Institute examination will qualify.

In effect this would exclude around 70% of brokers today who operate under the title of Insurance Broker, as it seems there may be no Grandfathering provision within these proposals.

Additionally, whole firms could be granted the status of Chartered Insurance Broker if the majority of their Directors qualify for the title individually. This could lead to some dramatic demotions and promotions in the next few years. Watch this space!

When I started my career in 1962 no one cared a hoot for Directors - it was all about Managers. Let me tell you a very true story.

I spent my first six years in the statistics department of C T Bowring, where I was blissfully happy and unchallenged. One Friday morning I was called into a meeting with the Manager of the Hull Department, a Mr Baxter (no one knew his Christian name). His Dickensian demeanour terrified the life out of those who came into contact with him. He wore a black jacket with tails, black and white pinstriped trousers, white shirt with a white cardboard reversible collar.

I was ushered into his office and sat down in a wooden chair situated in the far corner of the room. Mr Baxter then advised me that, much against his better judgement, he had been persuaded by some of his colleagues to take me into his department. This was, he advised, a great honour for me and represented 'a unique opportunity for me to make something of myself, the work was hard, technical but mentally rewarding', he said. Additionally; if I proved myself there was a hint of a pay rise in two or three years time. He settled back in his chair, indicating the interview was over.

I considered this news with horror and after taking a deep breath advised him 'that whilst I appreciated his confidence in me, I was quite happy where I was and felt no need to move on'. His face turned ashen and he appeared paralysed and incapable of speech, so I got up and left.

On returning to my office after that meeting I was told my desk was being moved to the Hull Department on Friday night and I was not to debate the point. I duly reported to the Hull Department at 9 o'clock the following Monday morning but there was clearly a problem.

It transpired that Mr Baxter had died in his bed on Friday night.

? ***(Slide 24)***

I come back to where I started by reiterating that being a Lloyd's broker means you are in a people business. The Lloyd's face to face negotiation is now unique within the Financial Services Sector. It's great to have University Degrees, Insurance Qualifications, Law Degrees, MBA's, IT skills, and the like but if you can't build up a trusting relationship with other professionals based on integrity and openness and maintain it throughout your career, don’t say you want to be a Lloyd’s Broker.

Thank you very much for listening.

Are there any questions?