Learning the lingo

RICHARD J ASTOR, A BARRISTER SPECIALISING IN LLOYD'S-EQUITAS LAW AND PRACTICE, GIVES HIS GUIDE TO LEGAL CURIOSITIES AT LLOYD'S AND EQUITAS.

Orientation: a culture of misunderstanding and obscurity

Seldom can a business as legally fecund as the Lloyd's enterprise have been so pregnant with legal misunderstanding, mythology and plain error. As a ready example of all three, poorly informed lawyers continue to refer in all earnestness to imaginary entities such as "Society of Lloyd's" and "Corporation of Lloyd's" - to the continuing amusement of the well-informed.

"Year"

Then there is the use of the word "year" simpliciter at Lloyd's, a perfect tool of confusion and obfuscation given the existence there of no less than four different types of "year": the calendar year, the underwriting year (the insurance equivalent of the financial year), the year of account (a collectivisation device, not a time period) and a year-of-account's operating year (strangely absent as a regulatory concept). Legal instruments, jurisprudence and other formal documents are replete with inept, often incoherent references to indeterminate types of "year".

Other terms of inconvenience

A considerable number of other terms of inconvenience continue to be deployed at Lloyd's in what appears to be a deliberate attempt to make the subject difficult. They include "underwriter" (as in "show to underwriters") to mean a managing agency; "premium" (as in "reinsurance-to-close premium") to mean reserve; "three-year accounting" to mean multi-year-of-operation closing, and "syndicate" (as in "which syndicate is on the risk?") to mean syndicate-year-of-account participants.

Credulity and ignorance

Such obfuscation finds a willing, uncritical audience in credulous lawyers and uninformed commentators. Far more serious is the curiously large number of legal infelicities, uncertainties and lacunae surrounding elementary aspects of insurance business at Lloyd's. These too appear to have found ready acquiescence among assured-side lawyers, especially in the US. Here are a few examples. The necessity to clarify such matters increases because (for example) the EquitasRe-assured-at-Lloyd's is excluded from the FSA's compensation scheme in relation to direct business at Lloyd's, and excluded from third-party rights against reinsurers under Third Parties (Rights Against Insurers) Act 1930.

"Ringfences" around liabilities at Equitas Re

There is widely thought to be a formal, valid, legally enforceable "ringfence" between the EquitasRe-assured-at-Lloyd's and the Lloyd's enterprise, and or between the Lloyd's and Equitas enterprises, dispossessing the EquitasRe-assured-at-Lloyd's of recourse to the Lloyd's enterprise for 100 percent of his valid claim. It is fashionable to seek to do cheap deals at Equitas Re in the belief that "Equitas" is all there is. With the tacit assistance of Lloyd's and the Financial Services Authority, Equitas Re continues to foster the impression that it, rather than Lloyd's, is the claimant's sole recourse and that he should be grateful for any payment from Equitas Re before it becomes insolvent.

The Myth of Dispossession

Such alleged dispossession, and those ringfences, are myths. Look for the slightest due process properly dispossessing claimant EquitasRe-assureds-at-Lloyd's of their rights to 100 percent payment at Lloyd's and it will be found conspicuously absent. Ditto any formal notice to any EquitasRe-assured-at-Lloyd's that he has been made the member of a surreptitious underclass at Lloyd's.

Council of Lloyd's double game

The Council of Lloyd's plays a double game. As between itself and EquitasRe-assureds-at-Lloyd's, it continues to make "chain of security" representations to all assureds-at-Lloyd's without discrimination: see for example the "Chain of Security" and "Security at Lloyd's" blandishments on the present Lloyd's website www.lloyds.com. None of them remotely suggests that the EquitasRe-assured-at-Lloyd's does not enjoy full securitisation at Lloyd's.

But the Council has done something much more serious. As between itself and members of Lloyd's, it has promulgated — without notice to the outside world — an obscure back-office provision in the New Central Fund Byelaw (No. 23 of 1996, as amended). The Council of Lloyd's there purports to prevent itself from using the New Central Fund "directly for the purpose of extinguishing or reducing any liability of a member [of Lloyd's] in respect of which Equitas Reinsurance Limited has, under an Equitas reinsurance contract, undertaken to reinsure and indemnify that member" without "the prior sanction of a resolution of the members of the Society in general meeting." Concerning this central provision, no assured-at-Lloyd's has been consulted or formally informed.

Role of Names in Lloyd's general meeting suspect

The provision is legally problematic. First, the Council appears to have acted not out of a sense of self-regulatory responsibility for claimants but out of solicitousness for corporate Names' personal financial welfare. Secondly, expanding the discretion of members in Lloyd's general meeting appears to be contrary to the policy of Lloyd's Act 1982, which removed exclusive byelaw-making power from members of Lloyd's in general meeting and gave it to the Council of Lloyd's. Thirdly, it is inconsistent with the security blandishments made by Lloyd's to all its assureds.

Fourthly, there appears to be no sound basis for giving members any sort of discretion over the Central Fund. The Central Fund could have been established by byelaw promulgated by members of Lloyd's in general meeting. Instead, it was established by "agreement" — the Central Fund Agreement of May 18, 1927 — which was imposed on members by the then Committee of Lloyd's at the very time that members had exclusive byelaw-making power. The Central Fund — and its financial and marketing benefits — was considered too important to be left to members' self-regulatory condescension. The history of the Central Fund, and the history of self-regulation at Lloyd's, each independently indicate that members of Lloyd's are not to be given any discretion over the existence or disposition of the Central Fund.

If it ever comes to a Lloyd's general meeting, members of Lloyd's are under no express obligation to exercise their new Central Fund discretion self-regulatorily. They appear to be free to withhold the New Central Fund in order solely to protect their own personal short-term financial interests. Indeed, there are no other grounds on which they could be expected to exercise their purported Central Fund discretion. Meanwhile the Council of Lloyd's continues to preside over the Lloyd's enterprise giving EquitasRe-assureds-at-Lloyd's the false impression that their recourse is solely to Equitas Re.

Use of Lloyd's personal assets

The Lloyd's enterprise's constitution — Lloyd's Acts 1871, 1911, 1951 and 1982 — contains no express provision requiring any member of Lloyd's to provide any money to any central fund for any purpose. What of the obligations of Lloyd's personally? Conspicuous by its absence is any duty on the Lloyd's enterprise centrally to pay any insurance claim. Particularly curious is Lloyd's Act 1911, s.7(c), which purports to leave entirely to the Council's "opinion" whether or not to use Lloyd's personal assets for "making good any default by any member of the Society under any contract of insurance underwritten at Lloyd's". If members of Lloyd's were to run out of money and all that was left to pay claims were Lloyd's personal assets, the Council has no obligation to use any of them to pay any claim. Strange. It gets stranger. The statutory criterion that the Council is required to have in mind when forming its opinion is not the interests of claimants but those of "the members of the Society". The statutory discretion purports to exonerate the Council from using Lloyd's personal assets to honour its public representations.

Conventional reinsurance-to-close

Conventional RTC is one of the most misunderstood features of the Lloyd's enterprise. Myths abound as to its nature and effects. For example, it is generally considered to be a type of reinsurance, a logical impossibility given that the outward-RTCed SYA participant is by definition incapable of ever suffering a loss. Second, it is considered to have no effect whatever on the insurance contractual liability of the outward-RTCed SYA participant, an administrative and legal impossibility given the numerous provisions in the Lloyd's internal rulebook infiltrating all the liabilities into the personal accounts of the inward-RTCing SYA participant.

Conclusion

The Lloyd's enterprise's longevity and superficial quaintness are equalled by the menace contained in its antediluvian legal uncertainties. No English court or insurance regulator has come close to clarifying its financial obligations to assureds-at-Lloyd's, especially to those entangled in Equitas Re. No external insurance regulatory authority, including the FSA, appears to genuinely understand its detail. English common law, which persists in terminological inexactitude (especially its use of "syndicate"), has not had to consider fundamental aspects of how the Lloyd's enterprise functions financially. In an uncertain commercial and financial climate, such legal uncertainties, especially in relation to getting paid, suggests that careful forethought be given to buying insurance at Lloyd's.