Once Bitten, Twice Shy?

Nigel Hanbury, Chairman of the Hampden members agency, describes why resigned Names may wish to consider rejoining Lloyd's. Many will be appalled at the thought but some others, including both the Chairman and the CEO of the ALM, have already rejoined.

Lloyd's: What Has Changed?

The recent interim results from Lloyd's point towards an improving 2007 account and a truly outstanding 2006. These two years follow a string of profits dating back to 2002 following the tragic *World Trade Centre* disaster in 2001. This profitable period was not free of problems; they included multiple hurricanes in 2004 as well as Hurricanes Rita, Wilma and the unbelievably destructive Katrina in 2005, but still the profits flowed. The Lloyd's of old would have been overwhelmed; so what has changed?

■ Franchise Board

The *Franchise Board* was introduced in 2003 to improve Lloyd's performance and to reduce the volatility of results that occurred in the 1990s. All managing agents are required to meet the franchise standards. These represent the minimum level of performance required of any organisation within the Lloyd's market. Any persistent and significant underperformance would result in the offending company suffering increased capital requirements or even being unable to continue trading at Lloyd's.

■ Number of Syndicates

The underwriting franchise is now represented by 75 syndicates, each of which needs to have appropriate systems and controls in place in order for the franchise to succeed overall. Contrast this with the position of over 400 individual syndicates in 1990, with varying degrees of competence.

■ Sale of Equitas

The reinsurance of Equitas by *Berkshire Hathaway* means that Lloyd's, an institution over 300 years old, effectvely has no pre-1993 legacy issues with which to cope.

■ Limited Liability

Losses are now restricted to the assets of the limited liability vehicles through which individuals now underwrite (Limited Liability Partnerships or Namecos).

Why Rejoin Lloyd's?

Lloyd's has changed, and so has the emphasis on why investors should consider putting their funds at risk. Gone are the arguments for tax efficient capital appreciation, bond washing, snob value etc. These are replaced by four simple drivers:

- Profit
- Double use of assets
- Low correlation with other asset classes
- Financial planning opportunities, such as 100% inheritance tax relief and pension contributions.

These reasons alone have been enough for a flow of new investors to join Lloyd's in the last few years. Some of them have been former unlimited liability members, like ALM CEO Anthony Young, who have chosen to return because of the changed environment.

Furthermore, the banking crisis and turmoil in the stock markets in recent weeks reinforces the attractions of including a direct investment through membership of Lloyd's as a separate asset class in its own right.

The insurance industry has not been immune to the financial crisis, with *AIG*, the world's largest insurer, being rescued by the *Federal Reserve Bank of New York*. Insurers are suffering a loss of capital as financial guarantee business and investments turn sour, suggesting that factors other than a big catastrophe loss could become the main trigger for increased insurance rates.

Can this be relevant to former unlimited Members who once traded at Lloyd's but are not doing so now? I think it may be, for three main reasons.

■ Generally speaking, those Names who have left Lloyd's, but have kept in touch through the ALM, have a significant and valuable base of knowledge which they have deliberately chosen to retain. They understand the vernacular of Lloyd's: years of account, RITC etc.

■ Many still have relationships within Lloyd's which are of considerable value.

■ An experienced Name may have a sufficiently robust constitution to be able to pick up a newspaper with 'Hurricane XYZ' on the front page and know that this event could be quite good for insurance markets in the long term, rather than an immediate reason to draft a letter of resignation!

LLP or NameCo?

The methods by which an investor can participate have effectively been refined to two:

1. A Nameco - a UK corporation paying corporation tax.
2. A Limited Liability Partnership (LLP), which is tax transparent and reflects most of the personal tax features of unlimited membership.

Both provide an effective wrap to protect the investor against unlimited liability and have very interesting tax features that are more relevant today than at any time in Lloyd's past, as described below.

Profits from an LLP qualify as relevant UK earnings and can therefore be paid into a pension scheme, subject to the current annual and lifetime limits which apply to all relevant UK earnings. Many individuals today, if they have a pension at all, are suffering significant impairment. An impoverished retirement is not a pleasant prospect and the new Lloyd's can help to combat that.

For those not interested in pension provision, a Nameco provides an environment within which profits can be sheltered at corporation tax rates between 22% and 28% and received as dividends, and therefore free of national insurance contributions, when desired. Non-resident owners will pay no UK income tax either, though they may be liable to tax in their home country.

Assets pledged to Lloyd's to support the underwriting of a LLP will qualify for 100% Business Property Relief from Inheritance Tax after an individual has participated for two years, as will the value of shares of a Nameco.

Should an individual want, or need, to gift or sell a material interest in a LLP or Nameco, then Entrepreneur's Relief from Capital Gains Tax will be available after one year's ownership, reducing the rate from 18% to 10% for gains up to £1m (this is a lifetime limit). Owners of shares in Namecos must also hold at least 5% of the voting capital and have been an officer or employee for at least one year before disposal.

Conclusion

The structural changes introduced since Lord Levene became Chairman mean that today's Lloyd's is light years away from what existed 20 years ago. The results are starting to speak for themselves. Even in poor underwriting years like 2005, Lloyd's has made money. It still offers effective double use of assets and it also offers low correlation with other asset classes, as is being amply demonstrated now. And the eminent economist, Professor Tim Congdon, noted in a paper last year that "An equities based investor who puts all his or her capital into Lloyd's as FAL should eventually double the return on capital".

Lloyd's is worth looking at again. A number of former Names have done just that.