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Innovations at Lloyd's from Revised Hull Wordings to Streamlined Claims Administration

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Contents

1. *Introduction*
2. *Lloyd's*
    a. *What is Lloyd's and how does it function?*
    b. *Recent changes*
3. *International Hull Clauses 01.11.2002*
4. *London Market Principles (LMP)*
5. *Conclusion*

1. Introduction

I am writing this paper at a time of fundamental and radical change at Lloyd's and throughout the London insurance market. As I shall explain below, Lloyd's has introduced far-reaching changes to its structure and procedures and has moved from self-regulation to external regulation in order to come into line with most other elements of the UK financial services industry.

I am conscious of the presentation given to the MLA meeting in Coronado in October 2001 by David Taylor, Special Advisor to the International Underwriting Association, at a time when there were serious concerns internationally regarding the survival of Lloyd's and the London market following the terrible events of 9/11 and the huge claims expected to fall upon us.

Fortunately our market has shown tremendous resilience in responding to the losses resulting from that awful day as well as those arising from other major catastrophes in 2001 such as the explosion at the Total refinery in Toulouse, France – a US$1.3bn insured loss, the total loss of the Petrobras P36 platform off Brazil, insured for US$500m and subsequent losses in 2002/2003 including Hurricane Lili and the tornadoes in April and May this year. Lloyd's has already paid out in excess of US$4bn for losses arising from 9/11 as at the end of August 2003.

Lloyd's has maintained its strong position in the global insurance industry with record levels of capacity for 2003 of £14.4bn (US$22.7bn) and expects to maintain this level of capacity for 2004. Although capacity has increased to record levels, the number of individual businesses operating at Lloyd's has actually reduced considerably over the last decade with the result that only 71 syndicates, albeit much larger entities, are underwriting in 2003. The most fundamental change however is that most of the managing agents are no longer relatively small, privately owned (usually by the underwriters) businesses but are now subsidiary companies of larger entities, either UK PLCs or overseas (re)insurance companies, wishing to write a proportion of their business in Lloyd's, usually business that they would be unable to access elsewhere.

Lloyd's has recently revised its projected overall loss for the 2001 account (the market currently reports on a three-year basis) to £1.78bn (US$2.81bn) but is expecting a return to profitability for 2002, projecting a profit of £1.67bn (US$2.63bn) and the signs are even better for 2003 following a relatively benign year to date for both catastrophe and attritional losses (except of course for our original venue Bermuda having suffered the effects of Hurricane Fabian, its worst hurricane for 50 years, and Hurricane Isabel wreaking havoc across a number of eastern States, both during the time I was writing this paper!)

2. Lloyd's

a. What is Lloyd's and how does it function?

Lloyd's is the world's leading insurance market providing specialist insurance services to businesses in over 120 countries. It is the world's second largest commercial insurer and sixth largest reinsurance group. Approximately 5% of world reinsurance

is placed at Lloyd's which also accounts for half of the London market's international insurance premiums.

I am indebted to John Woods of Thacher Proffitt & Wood for supplying me with details of three cases in which the ways of doing business in the Lloyd's market were explained to and summarised by US courts. The three cases are as follow;

1. Syndicate 420 at Lloyd's London v Early American Insurance Co. etc. from the Court of Appeals, Fifth Circuit **(796 F.2d 821)** – a case regarding forum non conveniens and the adequacy of the British courts.

2. John S Roby et al v The Corporation of Lloyd's etc. from the District Court S.D.New York **(796 F.Supp 103)** – are syndicates capable of being sued?

3. E.R.Squibb & Sons Inc v Accident & Casualty Insurance Co. etc. also from the District Court S.D.New York **(1999 WL 350857 (S.D.N.Y.))** – subject matter jurisdiction and the ability to sue representative Names (members of Lloyd's syndicates) and class action considerations.

The description of how business has been and generally continues to be underwritten at Lloyd's is probably best described in the second case, John S Roby et al etc. (which itself quotes the first case cited) and is as follows;

"Lloyd's of London is a venerable institution, dating back to the latter part of the seventeenth century, long known for its insurance business. Although Lloyd's is generally considered to be a unitary organisation, it actually is not, and in fact bears little resemblance to the typical corporate insurer. It issues no insurance policies. Rather, it acts as a market for the buying and selling of insurance risks.

According to the syndicates, the closest American analogue to Lloyd's is the New York Stock Exchange. Lloyd's provides the premises, administrative staff and support services for the market; it also issues rules and regulations and monitors transactions that occur in the market. Like the New York Stock Exchange, Lloyd's does not participate in individual decisions made by the brokers, members or underwriters.

The persons who carry on the business at Lloyd's are, respectively, the brokers, active underwriters, member's agents, managing agents, and Names (who make up the syndicates). The Names are the individual investors. They pay fees and delegate complete authority to conduct Lloyd's affairs to "member's agents". Although Names are the ultimate underwriters of the insurance, they do not participate actively in the underwriting process or in the recruiting of other Names to the syndicates. They have no management authority and cannot bind their fellow members or the syndicate. Membership in a Lloyd's syndicate is personal and not transferable and terminates upon the death of the member.

Member's agents recruit new Names and handle the admission of Names to Lloyd's membership. Member's agents are ordinarily also chosen to act as Names' underwriting agents and, in that role, are responsible for placing Names in syndicates. In connection with the latter, the member's agent contracts with a "managing agent" to place the member in a group comprised of two to several hundred other Names. These groups constitute the syndicates. Managing agents run

the syndicates. They hire the syndicate's active underwriter and maintain the syndicate's accounts and other records, among other things.

An employee of the managing agent, known as the "active underwriter", acts on behalf of the Names in a syndicate in the "buying" and "selling" of insurance risks. Active underwriters are seated on the underwriting floor at Lloyd's in London. Brokers approach the active underwriter at his desk—in Lloyd's parlance "the box"—to solicit the underwriter's agreement to accept a risk. The active underwriter decides which of the risks, offered to him by brokers, to accept and at what premium, and negotiates the conditions of coverage and the proportion of the risk his syndicate will assume.

Through their syndicates, Names subscribe to a certain percentage of the risk on policies, in return for a certain percentage of the premium paid to the syndicate by the insured. Normally, syndicates do not insure 100% of a risk. Rather, a number of syndicates agree to subscribe, each assuming a specified portion of the total risk. A syndicate member is entitled to a specified (contracted-for) share of the profits from the syndicate's business and is responsible for that share of loss only.

Although Names have unlimited personal liability for their respective share of the risk, a Name has no responsibility whatsoever for the liability of his fellow syndicate members. Section 8(i) of the Lloyd's Act of 1982 states:

'An underwriting member shall be a party to a contract of insurance underwritten at Lloyd's only if it is underwritten with several liability, each underwriting member for his own part and not one for another and if the liability of each underwriting member is accepted solely for his own account'.

In addition, when a Name becomes a member of a syndicate, the contract he or she signs specifies that [nothing in his or her agreement with the relevant member's agent or managing agent] shall constitute a partnership between the Name and the Agent or between the Name and any or all of the other members of the Contracted Syndicates.

Syndicates exist for one year, at the end of which they are dissolved and reconstituted. However, although syndicates are identified by numbers (e.g. Syndicate No. 670), the numbers are often reused from year to year and often, at their option, many of the same Names remain members. The Names elect each year which syndicates they wish to join. A syndicate closes its accounts for a given year by transferring its potential liabilities to the members of the syndicate in the following year of account, a practice called "reinsurance to close," and the same managing agents usually run the syndicates from year to year."

The only significant change to this description which affects the way in which business is written today is that most Names (and all new Names with effect from 2003) no longer have unlimited liability. This has resulted in the majority of the Names today being corporate investors instead of individuals of private wealth.

However Underwriters still sit at their "boxes" and brokers continue to traipse around Lloyd's and the City of London with cases full of paper slips and supporting documents for the business they are attempting to place.

The claims process is not described in this case but is briefly outlined in the E.R.Squibb & Sons Inc case as follows;

"When a claim…is presented, it is handled through a collective, coordinated approach in which all Names on a single policy, as well as Names on excess layers, adhere to the claims decisions of a single lead underwriter. Likewise, in litigation such as the present action, all Names irrevocably delegate the defense of their several liabilities to their managing agents who, in turn, stipulate to have all Names bound to a judgment against one, and further delegate responsibility for the defense of all Names' several liabilities to a handful of leading market participants and a single law firm.

It is well established that a Lloyd's policyholder……receives full payment on a judgment, regardless of any internal disputes within the Lloyd's market or defaults by individual Names, with any deficiencies or disputes resolved within the market. For example, among other things, Lloyd's maintains a Central Fund through mandatory contributions from all Names in the market to preserve the reputation of Lloyd's as an entity against defaults by individual underwriters on their contractual obligations. The Central Fund is "the ultimate guarantee" behind every Lloyd's policy."

This process too is generally carried out by claims brokers visiting the syndicates' claims adjusters at their boxes, usually armed with large stacks of paper files – invariably more paper than was involved in the underwriting process – although I will refer later in this paper to proposed reforms to the claims procedures including the use of electronic file repositories and the agreement of claims "on-line".

b. Recent changes

1. Lloyd's moves to a Franchise structure

The Council of Lloyd's established the Chairman's Strategy Group (CSG) in 2001 to examine the major strategic threats and opportunities facing Lloyd's. The CSG's membership was drawn from all the major market constituencies and its specific objective was to determine:

"The future vision and strategy for Lloyd's which will maximise the wealth of capital providers to Lloyd's over the next 10 years".

As a result of this initiative, the CSG proposed, and the membership of Lloyd's accepted at an EGM in September 2002, that in order "to improve profitability and performance, Lloyd's will move to a franchise structure which will create a disciplined marketplace of distinct, independent businesses, and will place clear obligations on the franchisor to promote the overall profitability of the market. This will be achieved by redefining the relationship between Lloyd's, as franchisor, and managing agents, as franchisees".

The relationship has subsequently been defined in a set of Franchise Principles which detail the objectives of the franchisor (Lloyd's) as well as the obligations of both the franchisees (managing agents) and the franchisor. Lloyd's has since published guidelines addressing underwriting, risk management and standards of service.

Lloyd's is also setting a long-term target of profitability for the market, defining a new business planning process for the syndicates, approving (or rejecting) syndicate business plans and monitoring the performance of syndicates against their plans.

The Council of Lloyd's established a Franchise Board towards the end of 2002 to replace the Lloyd's Regulatory Board and the Lloyd's Market Board, the first Franchise Performance Director being Rolf Tolle (ex Chief Underwriting Officer of the Faraday Group which is owned by General Re). The new Board is supported by two key committees: the Market Supervision Advisory Committee and the Capacity Transfer Panel. An Underwriting Advisory Committee has also been established to advise the Franchise Board on underwriting and risk issues.

The Franchise Board's goal is stated as:

"Creating and maintaining a commercial environment at Lloyd's in which the long term return to all capital providers is maximised".

The Franchise Board will look to the Lloyd's Market Association (see 3 below) to be the primary conduit for obtaining franchisees' views.

Amendments to the Lloyd's Acts will be sought at the appropriate time to fully modernise the governance of Lloyd's and to remove unnecessary business restrictions. One such restriction which is widely expected in the market to be removed is the inability of brokers to own and/or control managing agents, a restriction which was originally introduced in the mid-1980s following concerns over preferential treatment and conflicts of interest. These concerns are now seen to be dealt with by external regulators and no longer relevant to the provision of capital to the market in the current environment.

The CSG also proposed several changes to the capital structure of Lloyd's. The main proposals were as follow;

- In order to improve transparency, move to full implementation of annual accounting on an International Accounting Standards basis in line with or ahead of the international programme. Target date for implementation 1 January 2005

- Enable early release of surpluses to support ongoing underwriting in the interim period before annual accounting is implemented

- No new unlimited liability members of Lloyd's with effect from 1 January 2003

- Drive forward initiatives to accelerate the closure of existing and future syndicate years of account which remain open at the 36 month stage

- Support new investment in the Lloyd's market, including investment on a non-membership basis.

The Franchise Board produced a Franchise Plan for 2003 which will be a 3 year rolling plan, updated annually. The Board identified seven strategic imperatives;

i) To ensure franchise profitability consistently outperforms the opposition

ii) To have an outstanding risk management capability throughout the franchise

iii) To be the market of choice for policyholders, brokers and investors

iv) To have a competitive international trading platform

v) To protect, strengthen and promote the Lloyd's brand

vi) To have a high quality, cost effective business process within the franchise

vii) To attract, retain and develop the best people throughout the franchise.

The Franchise Board also produced a set of Performance Guidelines for managing agents and syndicates to work to during 2003, acknowledging that business plans had been compiled and insurance written prior to their introduction, but the Guidelines have now been confirmed as unchanged for 2004 and business plans have been compiled accordingly. The Performance Guidelines are as follow:

Profitability by product line

There should be a reasonable expectation of making a gross underwriting profit on each line of business every year.

Catastrophe exposure

a) Catastrophe exposure should be analysed using tools or methods that are approved by the franchisor

b) Each franchisee should manage to a minimum return period agreed by the franchisor

c) The maximum gross and net exposures to a single Lloyd's specified Realistic Disaster Scenario (RDS) event for a syndicate are up to 75% and 20% of syndicate capacity respectively.

Reinsurance selection

Each franchisee should have an approved reinsurer selection process.

Gross line size

The maximum gross line that a syndicate should have on an individual risk is 10% of capacity.

Reinsurance leverage

a) Each syndicate should retain a net minimum amount of exposure on each risk (e.g. 10% of gross line)

b) No syndicate should pursue an aggressive arbitrage strategy (e.g. building business using inadequate pricing on the back of reinsurance).

Multi-year policies

a) Non-cancellable policies covering a period of greater than 18 months should be recorded as multi-year policies.

b) Multi-year policies should either have matching reinsurance cover or be limited to the agreed maximum net exposure to the class of business as set out in the syndicate's business plan.

Overall market dominance by a franchisee

No franchisee should control more than 15% of the overall market capacity without the prior agreement of the franchisor.

Dealings with brokers

All broker commissions and charges should be included in the profit and loss account submitted to the franchisor.

Service Standards

a) Each franchisee should adhere to the service standards covering policy production and premium and claims payment as defined by LMP.

b) All policies should contain wording that allows cancellation to be forwarded directly to the policyholder should premiums be overdue (where legally possible).

Although the current Guidelines were introduced following extensive consultation throughout the market, there has never before been any such formal direction from Lloyd's as to how managing agents and syndicates are to operate their businesses and therefore, understandably, their implementation and interpretation has caused much debate and occasionally argument.

This is especially so for some of the larger syndicates who have historically written significant gross lines in excess of the Guideline amounts, usually with the benefit of extensive reinsurance. The classes of marine business most affected by the limitations in gross line are probably war, cargo and especially specie due to the very high values involved.

The first guideline, i.e. the expectation of making a gross underwriting profit on each line of business every year is also causing some considerable debate in the market, especially in relation to marine hull business which it has been widely reported has had a particularly bad time for the last few years.

Rates declined in every market across the globe to record low levels in the second half of the 1990s, often in conjunction with long-term policies (up to three years instead of the usual twelve months period) due to worldwide overcapacity and many underwriters attempting to retain their market share, often with little or no regard to price. Although the hull market has seen significant rate increases in the last three years, the class is still thought to be underpriced and only to have reached break-

even levels. Further increases are therefore considered necessary to return to an acceptable level of profitability and the required return on capital.

The Franchise Performance Director has reportedly already met with hull underwriters in Lloyd's and expressed his concerns regarding this class of business. Hopefully this will have the desired effect of maintaining the resolve of hull underwriters to increase rates. It is surely unthinkable that Lloyd's, where marine hull insurance began over 300 years ago, would cease to underwrite the class of business for which it was originally formed.

Further information about Lloyd's and the new franchise structure can be found at www.lloyds.com

2. Financial Services Authority

Lloyd's has been subject to self-regulation throughout its more than 300 years history but following the well publicised problems of recent years, much pressure was brought from both investors and overseas regulatory authorities to change the way in which the market was regulated. This resulted in the supervision and regulation of Lloyd's being formally transferred to the UK Financial Services Authority (FSA) with effect from 1 January 2003. Lloyd's therefore no longer has any regulatory responsibility over the market, and is indeed itself now regulated by the FSA, and the departments at Lloyd's previously responsible for regulation are now responsible for the operation of the Franchise structure.

3. Lloyd's Market Association

The Lloyd's Market Association (LMA) is the representative body for the underwriters and managing and members' agents at Lloyd's. It was formed in 2001 from a merger of the five previous market sector organisations. These were;

- Lloyd's Underwriters' Association (LUA) (founded in 1909 to represent marine underwriters)
- Lloyd's Underwriters' Non-Marine Association (NMA) (founded in 1910 to represent non-marine underwriters)
- Lloyd's Aviation Underwriters' Association (LAUA) (founded in 1935 to represent aviation underwriters)
- Lloyd's Underwriting Agents' Association (LUAA) (founded in 1960 to represent managing agents)
- Lloyd's Market Association (LMA) (founded in 1995 as the Lloyd's Corporate Capital Association)

The LMA's aim is;

"To provide a single voice for the Lloyd's underwriting market and a quality range of services that improve members' profitability".

As mentioned above, the Franchisor will look to the LMA to be the primary conduit for obtaining franchisees' views.

The LMA Board has a number of committees headed by the Underwriting and Claims Committee (UCC), chaired by David Foreman of Wellington, with members drawn

predominately from the underwriting community but including members' and managing agents as well as two claims practitioners.

There is also a Lloyd's Market Claims Group (LMCG), currently chaired by Gary Bass of Faraday, consisting mainly of senior market claims practitioners including the chairs of the three market sector Claims Committees. Jeremy Pinchin, the recently appointed Head of Claims and Reinsurance at Lloyd's, is also a member together with Clive Buesnel, the Managing Director of Xchanging Claims Services (XCS) (see 4 below).

There are then three market sector underwriting committees reporting to the UCC, i.e. Marine, Non-Marine and Aviation.

The Marine Committee consists of six elected members (chosen by the marine underwriters at Lloyd's), the chair of the Marine Claims Committee (currently myself) and the chairs of (or senior Lloyd's representative on) the Joint Committees. The recently elected chairman for 2003/04 is John Henderson of Marlborough.

There are six Joint Committees – consisting usually of 10 members drawn equally, where possible, from the Lloyd's and International Underwriting Association (IUA) communities – Hull, Cargo, Liability, Rig, War and Excess of Loss.

There is also a Joint Claims Committee, currently chaired by Charlotte Warr of Goshawk, consisting of 6 members of the Marine Claims Committee and 6 members of the IUA Claims Committee (which is currently chaired by Geoff Sutherland of ERC Frankona). An appropriate representative from the Joint Claims Committee also sits on each of the six Joint Committees.

Each of the above committees meets on a monthly basis. Details of future meetings can be obtained from the respective chairperson and visitors to the London market are always welcome and indeed encouraged, subject to prior notice, to attend and address any of the claims committee meetings.

Further information about the LMA can be found at www.the-lma.com and at www.lma@lloyds.com

4. Lloyd's Claims Office (LCO) / Xchanging Claims Services Ltd

Lloyd's underwriters handle the majority of their claims in accordance with the Lloyd's 1999 Claims Scheme (the Scheme). The Scheme provides an efficient means of handling claims in the subscription market and avoids the necessity of claims having to be agreed by all participating Lloyd's underwriters. The basis of the Scheme is as follows;

"The claims under this scheme will be handled in all respects by the leading underwriter on his own behalf and with LCO binding the following underwriters provided it agrees with the leading underwriter. The LCO may refer, either at its discretion or on the recommendation of the leading underwriter, any part of the handling of a specific claim directly to such following underwriters as are appropriate".

There are some exceptions to this situation, mainly for "legal liability" claims but also for Bankers' blanket bond, Contract frustration, Political risks and Satellite risks where the agreement of the first two Lloyd's underwriters in slip order and LCO is usually required.

However, marine liability claims such as P&I, Shiprepairers' liability, Charterers' liability and Cargo liability are only treated as exceptions if the claim involves US assureds or subsidiaries or where a US lawsuit has been filed or the occurrence is in US territorial waters.

In December 2000 the LCO, which was wholly owned by the Corporation of Lloyd's, was formally split into two subsidiary companies, namely LCO Marine Ltd and LCO Non-Marine and Aviation Ltd.

As part of a widespread reorganisation of the operations of the Corporation of Lloyd's, the Council decided to outsource a number of functions, including claims, and subsequently in November 2001 arrangements were completed for the transfer of ownership of the two companies to a new company, Xchanging Claims Services Ltd (XCS), a company jointly owned (50/50) by Lloyd's and Xchanging.

XCS continues to provide the same services to Lloyd's underwriters as previously supplied by LCO and the Scheme has been amended accordingly. The Scheme, which was first introduced in Lloyd's in 1989 as the "Unified Claims Scheme" and has been periodically amended, is currently under review by Lloyd's although it has proved over time to be a success and therefore no major changes are anticipated.

5. Expert fee collection

The final recent change on which I can report is probably closest to the hearts (and pockets) of the readers of this paper, namely enhancements to the way experts' fees are collected and paid by Lloyd's and London market underwriters and to a limited extent overseas insurers.

Historically the London market (Lloyd's and Companies) has relied heavily on the London brokers to collect experts' fees and then pay the experts in a timely fashion. In most instances, brokers view experts as working on behalf of the underwriters and therefore consider the responsibility for payment should reside with the underwriters. In turn, the underwriters believe the brokers should resolve the issues of late payment as part of their ongoing role in the claims process.

There is also considerable debate and disagreement amongst claims practitioners in the London market with regard to whether the expert, especially if appointed by insurers, should pay for prompt payment of his fees by way of a commission to the collecting party, usually through a percentage or monetary deduction from his invoice. Some believe that the cost of collection and payment should be met by the expert but others consider that the insurer(s) should meet the costs involved.

However, I am not aware that any insurer has yet been able to devise an efficient scheme to operate in a worldwide subscription market whereby the true costs involved are paid by the insurer(s). If fees are to be collected and paid by a third party other than the broker (his costs being incorporated in any brokerage and commission already agreed at the time of placing the business), that third party will

seek to make a profit from operating such a scheme and none to my knowledge have been prepared to base their model on payment from insurers for the service, preferring the certainty of payment by deducting their charges from the invoice being settled.

Xchanging Ins-sure Services Ltd (XIS), a company established along similar lines as XCS above to incorporate the Lloyd's Policy Signing Office (LPSO) and the London Processing Centre (LPC) and which is owned 25% each by Lloyd's and the IUA and 50% by Xchanging, is the company responsible for processing premiums and claims for the London market.

In June 2003 XIS, in conjunction with XCS, re-launched the Lloyd's Direct Fee Scheme as the Expert Fee Service (EFS). EFS is an end-to-end electronic service for experts and underwriters in the insurance market where EFS accelerates payment on behalf of experts for invoices submitted to brokers and underwriters, in return for a pre-agreed commission deducted from the value of those invoices.

I am not making any recommendations herein with regard to the use of or appropriateness of EFS but have set out below the details of the service for information purposes. I am aware that a large number of experts both in London and the US have already been approached by XIS, many of whom have signed agreements with XIS to use EFS for all or part of their fees, some for short periods only on a "pilot" basis, but some have declined to participate mainly, I have been informed, due to the quoted prices.

It is unclear why the previous Direct Fee Scheme was used predominately by experts for non-marine and aviation business and was not used by many experts for their marine fees, although several experts carried out work for the market on all classes of business. I can only conclude that marine brokers may have been more willing to continue to collect fees than their non-marine and aviation colleagues.

If choosing to use EFS, experts are invited to submit all of their invoices (exceptions to be agreed in advance) to the EFS in order to provide sufficient economies of scale to sustain the commercial model of the service.

The following prices and service levels will be applied to all invoices collected and paid by XIS:

		Service Levels (in working days to settle)		
Insurer Type	**Value of market**	**0-30**	**31-60**	**61+**
Lloyd's only	<£2,000	£75	£37.50	£37.50
Lloyd's only	>£2,000	£150	£75	£75
IUA only	NA	£150	£150	£75
IUA monthly only	NA	£150	£150	£150
Non Bureau only	NA	£150	£150	£150
Mixed Market*	NA	£225*	£225*	£225*

∗ Note that this is the maximum price. The price to be paid will be split proportionately across the relevant insurer types and according to the service level of that insurer type.

1. For Lloyd's market only invoices, the price shall be £150 where the Lloyd's proportion of the invoice value is greater than or equal to £2,000 and where XIS collects payments in less than 30 working days. After 30 working days, the price shall be reduced to £75.

2. For Lloyd's market only invoices, the price shall be £75 where the Lloyd's proportion of the invoice value is less than £2,000 and where XIS collects payments in less than 30 working days. After 30 working days, the price shall be reduced to £37.50.

3. For IUA Daily / Weekly market invoices, the price shall be £150 if XIS collects payments in less than 60 working days, regardless of the value of the invoice. After 60 working days, the price shall be reduced to £75.

4. For IUA Monthly market invoices, the price shall be £150 regardless of the value of the invoice and regardless of when XIS collects payment.

5. For Non Bureau market invoices, the price shall be £150 regardless of the value of the invoice and regardless of when XIS collects payment.

6. Where XIS is requested to collect from two or more of any market (Lloyd's, IUA Daily/Weekly, IUA Monthly, Non Bureau), the price shall be £225 regardless of the value of the invoice. The price is split proportionately across the relevant insurers and the service level days that apply to that particular insurer.

   For example purposes only, if an invoice is received for £10,000 and with 80% (£8,000) from the Lloyd's market and 20% (£2,000) from the IUA Daily/Weekly market, then assuming that XIS collects the Lloyd's proportion on working day 35 and the IUA Daily/Weekly portion on working day 40, the price would be £135 ((Lloyd's: (£225*80%)/2 = £90) + (IUA: £225*20%=£45)). If the Lloyd's proportion had been collected within 30 working days, the price would have been £225 (£180+£45).

Notes:

- Working Days are defined as Monday to Friday, excluding English public holidays and bank holidays
- The price is payable on the complete value of the invoices (i.e. fees, disbursements and taxes)
- The price only becomes payable on remittance of the value of the invoice (or portion thereof) to the expert. If the invoice is not collected, there is no fee payable
- If the value of the invoice is less than the price to collect that invoice, the invoice will be returned to the expert for further consideration
- Where the fee reserve held by the insurer(s) is less than the value of the invoice, both the expert and the insurer(s) shall be informed by XIS
- VAT is payable by non-UK based experts at a rate of 0%.

Further information on EFS can be obtained from either david.gosden@ins-sure.com or tony.graves@ins-sure.com

3. International Hull Clauses 01.11.2002

The Joint Hull Committee, under the chairmanship of Simon Beale of Amlin, decided at the beginning of 2002 to set up a working party consisting of underwriters, brokers and a member of the Association of Average Adjusters with legal advice from Hill Taylor Dickinson to review both the Institute Time Clauses - Hulls 01.11.1995 and the Institute Time Clauses 01.10.1983 and produce a new set of clauses to accurately reflect the needs of both shipowners and insurers in the 21st century.

It was felt that the 1995 clauses had not been as successful as originally hoped, being introduced (with the benefit of hindsight) at the peak of the last cycle. The hull market was becoming over capacitised due to the perceived profits to be made and therefore the power was switching from sellers to buyers and not least to their representatives, i.e. the brokers.

Since their introduction, although used fairly extensively in London, the 1995 clauses have also rarely been used without significant deletions and amendments which dilute all or most of the changes between them and their predecessors, i.e. the 1983 clauses.

The working party, under the chairmanship of Peter McIntosh of Wellington, duly produced such a set of clauses following extensive consultation with shipowners and other interested parties. Entitled "International Hull Clauses – 01.11.2002", they are not a rewrite of the 1983 and 1995 clauses but have been produced to embrace current market practice whilst formally recognising and supporting the role of ISM, flag states and classification societies.

The drafters of the 2002 clauses placed far less emphasis on the use of warranties, preferring to provide specific explanations of the consequences of failure to comply with policy conditions. This reflects views expressed in recent cases by judges in the UK courts that the remedies for breach of warranty available to the parties are inequitable, especially if the breach of warranty was not causative of the loss, whereby insurers could avoid the entire policy whereas the shipowner could only recover his premium.

The 2002 clauses have also been constructed in a logical sequence and in 3 parts. Part 1 contains the principal insuring conditions and Part 2 contains a number of additional optional clauses for use where required by the shipowner or insurers, e.g. 4/4 RDC, General Average Absorption and Additional Perils. However, Part 3 is probably the most significant change to the previous clauses, incorporating a set of claims procedures setting out the rights and duties of both parties in relation to the submission, review and agreement of claims which it is expected will streamline and clarify the claims process for both the shipowner and his insurers.

These are the only clauses to my knowledge which incorporate claims procedures and which clearly identify the roles to be performed by both parties, such matters usually being dealt with, if at all, elsewhere within the overall policy terms and conditions.

The major changes to the principal insuring conditions are as follow;

- The cost of correcting a latent defect is not covered. Cover is afforded for loss or damage caused by a latent defect but only to the extent that the costs exceed those which would have been incurred had the defect been discovered and corrected at inception. This reverts to the position understood by insurers prior to the **"Nukila" [1997] 2 Lloyd's Rep 146**.

- An additional limit of 25% of the insured value of the vessel has been included for costs incurred arising from collision liabilities. No such limit previously existed.

- Compliance with ISM and Classification Society requirements has become mandatory. The policy is automatically terminated due to failure to have valid ISM documentation, to maintain Class or to comply with Class requirements affecting seaworthiness.

- Automatic termination also applies if there is any change of flag or management or upon bareboat charter or requisition of the vessel.

- Any voyage for break-up will also cause automatic termination of the policy.

- The assured must comply with flag state and Class reporting requirements. No cover is afforded for any loss attributable to any such non-compliance.

- Constructive Total Loss is payable by insurers if the cost of repairs or recovery exceeds 80% of the insured value of the vessel.

The major changes in the Additional Clauses are as follow;

- The Trading Warranties are no longer warranties but are now limits on cover.

- Lay-up returns are only permitted where agreed at the time of placing.

- There is a new optional Additional Perils clause to cover costs not recoverable under the latent defect provisions in the principal insuring conditions.

The major changes relating to the submission and handling of claims are as follow;

- A new Leading Underwriter clause provides authority to bind following underwriters.

- Failure to notify insurers within 180 days (90 days in the 1995 clauses) of the Assured, Owners or Managers becoming aware of any accident or occurrence will preclude cover. All reference to the (highly controversial) inclusion of the knowledge extending to superintendents and shore-based management which was included in the 1995 clauses has been deleted.

- The duty of good faith on the Assured applies throughout the claims process and does not cease upon commencement of legal proceedings. The intention is to reverse the effects of the House of Lords ruling in the **"Star Sea" [2001] 1 Lloyd's Rep 389.**

- Insurers will make a decision on a claim within 28 days of a fully documented presentation.

- Recoveries are to be shared "pro rata" to insured and uninsured losses. Recoveries were previously paid on a "top down" basis.

Unfortunately however, despite the huge amount of effort expended by the working party, probably the widest consultation with interested parties ever undertaken in the revision of any London market clauses and a number of presentations made to shipowners', insurers' and brokers' organisations around the world by members of the Joint Hull Committee, there has been minimal take-up to date of the 2002 clauses. Indeed the number of slips placed on these clauses is allegedly still in single figures as the focus by (most) hull underwriters since their introduction has been on price throughout the 2002/03 renewal season and 2003 to date. Unfortunately brokers also continue to recommend alternative clauses as more appropriate to their clients' needs, their preferred clauses usually being the American Hull Form, the Norwegian Plan or the 1983 clauses in that order.

Undeterred by this lack of adoption of their product the working party, as promised when the 2002 clauses were launched, has embarked on a full review and invited further comments and suggestions from all parties who were involved in the original consultation process. A draft amended version has recently been released for further comments and a final revised version of the clauses will be issued in late October for use after 1st November, 2003.

As expected, especially with the limited experience to date due to the low level of use and little claims experience, and other than the tidying of some language, the draft contains a limited number of proposed changes to the original version, the major changes being as follow;

- Latent defect. The exclusion for costs incurred in correcting the latent defect has been modified to exclude only half of such costs.

- Recovery of the vessel's proportion of salvage, salvage charges or General Average is no longer reduced in the event of any under-insurance.

- Similarly all reductions in the recovery of sue and labour costs due to any under-insurance have been deleted.

- The notice of claims to insurers has been changed from within 180 days of the Assured, Owners or Managers becoming aware of any "accident or occurrence" to becoming aware of any "loss, damage, liability or expense".

- The "bail" clause has been shortened to the first paragraph only, i.e. a simple statement that the Underwriters shall give consideration to assisting the Assured and all other conditions and criteria have been deleted.

It remains to be seen whether these additional changes, all of which soften the conditions in favour of the Assured, will be sufficient for shipowners and especially their brokers to request or recommend the revised clauses for their next renewal.

The problems and unprofitability of recent years of the worldwide hull insurance market have yet again been fully described by a number of leading figures at the recent IUMI conference in Seville, although I could find no reference in any of the speeches or written articles and interviews in the trade press which referred to the use of the new clauses, so I assume price will still be the driving factor in the next round of renewals. However, if London hull underwriters are unable to convince their policyholders of the efficacy of these clauses during the forthcoming 2003/04 renewal season or during 2004, I consider it unlikely that they will ever be used to any material extent.

Further information regarding the International Hull Clauses can be obtained from neil.roberts@lloyds.com

4. London Market Principles (LMP)

In January 2000 the Lloyd's / IUA Forum, a high level group consisting of the Chairmen of Lloyd's and the IUA together with senior executives from the major insurers and brokers in the London market, established a joint working party known as the Protocols and Standards Group (PSG). The PSG was tasked with identifying how the London market could meet the challenges of ensuring:

- The prompt and efficient payment of claims, the timely issuing of policies and the payment of premiums on due dates
- The setting and publishing of key service standards showing the performance of brokers, underwriters and central services, thereby reinforcing the pressure to improve service
- The improvement of access to the London market by simplifying procedures, adopting international processing standards and sponsoring joint developments between LPC and LPSO (since combined and become Xchanging Ins-sure Services).

Subsequently in May 2000 the PSG issued a document entitled "London Market Principles 2001" (LMP2001) which outlined the changes necessary to achieve these challenges. Their four most important recommendations were as follow;

1. A single underwriter to manage the underwriting and administration process on behalf of the entire market.
2. A restructured London market slip, designed to bring clarity at the point of contract. It will set out who is expected to do what and by when.
3. A single claims lead. The leader will be expected to inform and consult the other participants, but there will be just one claims interface.
4. A powerful market standards agency whose job it will be to collate, verify and publish statistics. IUA members, Lloyd's syndicates and brokers will be able to compare themselves against eleven performance measures.

However, due to the extent of the proposed changes progress was very slow, so slow in fact that the first casualty was the dropping of the date 2001 from the title!

David Taylor, in his address to the MLA in October 2001, reported on the proposals and commented that;

"The LMP project is well under way. It will be no surprise to know that perfect harmony and understanding is sometimes more difficult to achieve than might be hoped but never the less the momentum for this substantial change is there and will doubtless carry the changes through to fruition".

Unfortunately the momentum was lost for a while following the appointment of new chairmen of both Lloyd's and the IUA in 2001 and as other issues took precedence, especially in the aftermath of 9/11. However there has been some progress, especially with regard to recommendations 1 and 2 above.

A considerable amount of work was done during 2001 with regard to the production of a General Underwriters' Agreement (GUA) and accompanying Class of Business Schedules which were issued to the market for use with effect from October 2001. The intention of the GUA and Schedules is to replace the myriad of existing lead underwriter agreements, e.g. LUAMH for hull business and LUAMC for cargo, with a standard approach but amended appropriately for the peculiarities of each class. The GUA issued in 2001 has remained unchanged but there have been several changes to the Schedules with all marine classes of business except Liability now having an agreed Schedule. It is hoped that Liability will be completed this year.

The GUA determines the basis upon which the specified slip leader and agreement parties may act as agents of the other underwriters subscribing to the risk, each for its own proportion severally and not jointly, in dealing with certain alterations, amendments and additions ("Alterations"). It lays out the procedures to be followed and contains, inter alia, effective dates, arrangements for slip leader or agreement party replacement and general administration.

The Schedule is split into three parts, namely;

Part 1. Alterations the Slip Leader may agree on behalf of all Underwriters.

Part 2. Alterations the Slip Leader and Agreement Parties may, if unanimous, agree on behalf of all Underwriters.

Part 3. Alterations which may be agreed only by all Underwriters.

Generally, Part 1 contains alterations of an administrative nature and straightforward changes which do not increase or materially affect the risk. Part 3 contains alterations which would increase the Underwriters' exposure either monetarily or by extension of the period. Part 2 is only for those alterations not specifically mentioned in Parts 1 or 3.

However the inclusion of a GUA and Schedule is not mandatory in an LMP slip and underwriters are free to continue to use the existing lead underwriter agreements where they feel them to be more appropriate. It is apparent that hull underwriters are readily adopting the GUA and Hull Schedule whereas cargo underwriters are invariably retaining the LUAMC agreement procedure.

The LMP slip retains the basic structure of the traditional slip, i.e. it is split into three panels. Panels 1 and 3 which contain policy reference/bureau signing information and underwriters' lines respectively remain unchanged but no "small print" is to appear in Panel 1. Panel 2 is where the slip differs from the traditional format. It is organised into four sections, clearly separating out the risk details from the other information necessary to support the placement and the subsequent management of the contract. The four sections are;

- Risk details. This section contains contractual details of the insured, type, coverage, conditions, premium etc. forming the basis of the policyholder's insurance documentation. There are also new headings introduced to increase the clarity, accuracy and completeness of the slip, i.e. Choice of law and jurisdiction, Several liability, Payment terms, Other deductions from premium and three optional headings – Express warranties, Conditions precedent and Recording, transmitting and storing information, to be used where appropriate.

- Subscription agreement. This section relates to the management, servicing and processing of the contract and specifies the basis for contract changes i.e. the GUA or other lead underwriter agreement procedure, claims handling and identifies the slip leader and other agreement parties (and any delegation by any of them to third parties), service providers and bureau arrangements.

- Information. This section contains all information (or full and clear reference to information) made available to underwriters at the time of placing in support of risk assessment.

- Fiscal and Regulatory. This section contains names, types and amounts of taxes and other charges payable by underwriters.

The theory is that if all of the above is correctly entered on the slip and any information of a TBA nature is identified and a time frame agreed for the actual information to be advised and agreed, there should be far less scope for future disputes regarding non-disclosure, misrepresentation etc. and the market will therefore be able to reduce it's spending on unnecessary legal disputes.

The LMP slip is being used to an increasing extent throughout the London market, although the quality of the presentations often leaves much to be desired. Although there are detailed guidelines for brokers on the way to compile an LMP slip, some are still making little effort to present their slips in a consistent format with the result that underwriters are probably more confused with the proliferation of LMP slips than they were before it was introduced!

Underwriters are not free of blame however for this situation, many having shown scant regard for LMP since its inception. It is still seen by many as purely an administrative exercise and not something to really concern them. There were a number of explanatory seminars and presentations in the second half of 2000 and the first half of 2001 when the proposals were introduced but they were poorly attended by underwriters, although claims and accounting personnel showed considerably more interest.

However as there has apparently been a significant increase in the use of LMP slips during 2003, the figures at 30th June indicating some 70% of business now being

placed on them (although varying considerably over classes of business and again the quality is indifferent with some old style slips just having LMP written at the top!), it is possible that the executives of Lloyd's and the IUA may make the use of LMP slips mandatory for 2004. Indeed Nick Prettejohn, the CEO of Lloyd's, continually stresses in his public speeches the need for London to embrace and adopt LMP as soon as possible.

Disappointingly, as the progress has been so slow to date with regard to the introduction of these new and amended practices within the underwriting side of our business, it has been very difficult, if not impossible, to introduce the LMP Claims Protocol which was contained in the original LMP proposals. This envisages probably even more change to current claims handling procedures than are being introduced at the point of underwriting.

The LMP Claims Protocol, which was published in February 2001, sets out a clearly defined claims handling process for all insurers who transact business through the London market bureau. The Protocol contains provisions for the number of agreement parties (which will be stipulated on the slip), disagreement, delegation, agreement parties in run-off or insolvency, conflicts of interest, the role and responsibilities of the slip leader, other agreement parties, the other insurers and the broker, and for payment. The main provisions are as follow;

- The claims under the protocol will be handled in all respects in accordance with the number of claim agreement parties defined in the slip at the time of placement. The number of claim agreement parties will be defined in one of the following four options:

1. Slip leader only
2. Slip leader and trusted third party (e.g. XCS)
3. Slip leader and up to two other insurers
4. Slip leader and up to two other insurers and trusted third party

- Except for ex gratia settlements, commutations or policy rescissions, all other insurers will be bound by the decisions of the claim agreement parties.

- The slip leader must nominate the trusted third party, if required, at the time of placement.

- The insured or his agent has the right to insist that all insurers on the slip consider a claim.

- Where a claim agreement party is in run-off it may continue to undertake the agreement of claims provided that all insurers agree.

- Where a claim agreement party is insolvent it will not be permitted to remain a claim agreement party.

- The slip leader is responsible for adjusting claims, negotiation with the insured or its broker and notifying all insurers of any proposed payments or settlements of a claim.

- The slip leader is also responsible for some of the management, administration and agreement of claims subject to the provisions of the slip. The duties include:

1. Communication and review with other agreement parties
2. The appointment and management of insurers' experts
3. The creation and issue of CLASS advices to all insurers
4. The creation and maintenance of an electronic claim file that gives concurrent access to all insurers
5. The initiation of settlement
6. The management of direct payments where appropriate

However the broker may perform some of these duties dependent upon the role of the broker defined in the slip at the time of placement. One of the following roles will be defined:

A. Full involvement, where the broker will, inter alia:

- Notify insurers of a claim
- Create the CLASS entries
- Create and maintain an electronic claim file
- Negotiate with the claim agreement parties
- Act as intermediary between the insurers and the insured

B. Partial involvement in the insurer advising process, where the broker:

- Notifies insurers of a claim
- May create and maintain an electronic claim file, otherwise the slip leader will create and maintain an electronic claim file
- Acts as intermediary between the insurers and the insured

C. No involvement

- All insurers will have concurrent access to the electronic claim file created and maintained by the slip leader or the broker.

- All insurers will receive notification of claim advices and material changes to the status of the claim through CLASS.

However since publication, the LMP Claims Protocol has not been reviewed or approved by the market practitioners and will undoubtedly be substantially amended prior to its eventual introduction. It will also be seen from the above outline that the entire protocol depends upon all insurers installing the CLASS system (currently only used by the IUA companies although an amended version is now being used by XCS) and the introduction of electronic claim files. Both requirements are some way from being introduced and therefore it will be a considerable time before the Protocol can be formally adopted throughout the London market.

Several "pilot" schemes are being trialled and tested in the market between a number of insurers and brokers and it is also expected that a central electronic market repository will be established in 2004. XIS have developed such a repository and a team from the LMA is currently negotiating with XIS to produce proposals for use by Lloyd's. A similar team is also expected to negotiate with XIS on behalf of the

IUA. Hopefully proposals will be put to all participants in London early next year in order to facilitate the introduction of the new practices as soon as possible.

Further information on LMP can be obtained at WWW.LMP-REFORMS.COM or lmp@lmpoffice.com

5. Conclusion

I apologise for the length of this paper but I hope readers will appreciate from its content the extent of change in the Lloyd's and London market in the last three years and the amount of change planned in the foreseeable future. Exciting is not a word often associated with the insurance industry but I consider the next few years should bring some exciting changes and improvements to the way business is done in our market and indeed in the industry worldwide, especially from the viewpoint of someone who has now worked and survived for 32 years at Lloyd's!

Philip Cornick.

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Chairman of the Lloyd's Market Association Marine Claims Committee

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