



DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/
Secretary of State for Trade and Industry

31 January 1985

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Andrew,

This note is a supplement to the briefing for the Prime Minister's lunch at Lloyd's on 1 February, concerning the future role of the Chief Executive at Lloyd's. I have not circulated this letter as this is a delicate matter.

2 On the whole the Department's counsel is to keep off the question of the Chief Executive. In strictest confidence we know that relations between Mr Miller and Mr Hay Davison are often tense. If the subject comes up, the Prime Minister might like to say that the appointment of a Chief Executive from outside Lloyd's does look to have been advantageous at the time when it was done. When the time comes for a new appointment, care will be needed to take into account both the public reputation of Lloyd's and the necessity for efficient and impartial management supervision in Lloyd's.

Yours sincerely

Maureen Dodsworth.

MAUREEN DODSWORTH
Private Secretary

JH2AEO

Chief executive points way ahead for Lloyd's

By Lee Coppack, Insurance Correspondent

TWO years ago Mr Ian Davison left the comparative obscurity of his position as managing partner of accountants Arthur Andersen to become the first chief executive of Lloyd's at the request of the Governor of the Bank of England.

Since then he has scarcely been out of the news despite his announced intention to bore the press out of its fascination with Lloyd's simply by overwhelming journalists with information.

Looking back this week, he admitted that he knew little about Lloyd's two years ago, but felt it had allowed him to come fresh to a market that was eager for change.

Parliament had just passed a major new law to reform the market, the first significant Lloyd's Act for more than a century, and there had been a series of scandals involving some of its best known figures.

Mr Davison said: "When I came here I had no doubts that this would be a difficult job, and I have not been disappointed."

His breezy, sometimes abrasive style has produced occasional off-the-record mutterings from the market, but generally the City feels that having arrived at a critical time for Lloyd's, he has helped restore its credibility and give it a professional look.

Restoration of Lloyd's confidence with Parliament, the Department of Trade and Industry, Britain's insurance regulatory authority, and the press was one of the four main tasks facing the new chief executive who added that he was "working with the wind because the market and committee were very supportive."

Part of achieving this confidence was for Lloyd's to establish formal disciplinary procedures separate from its governing committee or council. "Lloyd's had been attacked by its critics as operating a kangaroo court," said Mr Davison.

The new council addressed itself



Mr Ian Davison

to the issue early, but it took time to get the machinery in place and has taken even longer to complete major actions.

Mr Davison admitted: "The slow progress has been a problem. We are now looking at the procedures to see if things can move faster."

He said this would not include a radical change in method to an inquisitorial hearing from the adversarial system in use where Lloyd's and the accused member put their cases to leading counsel, but could include offering the defendant a chance to dispense with referral from the disciplinary committee to the council for confirmation or reduction of penalties.

However, Mr Davison believed: "The disciplinary process is standing the test of time."

Other important areas of work were rule making and the management or civil service of the Corporation of Lloyd's where there had been an "officers and men" type relationship between the committee, made up of working members of the market, and staff.

The character of Lloyd's government has also changed significantly with the introduction of a council including external names and three

eminent non-members in addition to the committee elected from within the market.

Mr Davison said he arrived as the council started and it was originally suggested that it might delegate most of its powers to the committee, but this idea was quickly quashed by the external and nominated members.

He said there was still work to be done in these areas, completing various disciplinary actions and introducing rules to regulate Lloyd's brokers, for example.

But with confidence in the market restored, Mr Davison stressed that Lloyd's now needed to concentrate on areas "fundamental to its commercial survival."

These were the capacity squeeze caused by hardening rates and the strong dollar, computerisation, cash flow and market services including claims handling.

In the background is Lloyd's continuing discussion with the Inland Revenue. Mr Davison felt that the general tax concessions were in no peril but that the outstanding issues on reinsurance allowances needed to be settled as Lloyd's drew in more members to increase its capacity.

Mr Davison did not speculate on his own future. His contract with Lloyd's has a minimum of one year and maximum of three years to run, and he wants to ensure his successor takes over a "smoothly run ship" though there was still some way to go.

At the end he expects to go back to Arthur Andersen. He said it could be a little tame, but while at Lloyd's he has become involved with both the Royal Opera House and Victoria and Albert Museum and would have time to spend with them.

"I said when I came that I was an agent of change. Those changes are coming about. I think when I leave Lloyd's will need someone more capable of sailing the ship on the high seas."

CONFIDENTIAL



DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

PS/
Secretary of State for Trade and Industry

31 January 1985

Andrew Turnbull Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Andrew,

LUNCH AT LLOYD'S

I am enclosing briefing for the Prime Minister's engagement at Lloyd's on Friday. This takes into account some comments by the Treasury.

2 Your letter of 21 January mentioned three subjects raised by Lloyd's themselves. They are covered in the briefing.

3 The subject of the exchange rate and its effects on Lloyd's is a rather technical one to raise with the Prime Minister, and we are not clear what Mr Miller wants to propose. Official level contacts with Lloyd's suggest that Lloyd's officials are not clear either. We recommend that the Prime Minister steers Lloyd's towards finding their own solutions to any technical problems.

4 On the three subjects that the Prime Minister herself might put to Lloyd's, we agree that it would be useful to raise the questions of preferred underwriting and also of related party reinsurance. On the question of the role of the Chief Executive, I enclose a separate letter.

5 I am copying this letter to John Bartlett (Governor of the Bank of England's Office) and Leigh Lewis (Office of the Minister without Portfolio).

Yours sincerely
Maureen Dodsworth

MAUREEN DODSWORTH
Private Secretary

JH2AEN



BRIEF FOR THE PRIME MINISTER'S VISIT TO LLOYD'S,
FRIDAY 1 FEBRUARY 1985

PURPOSE OF MEETING

Lloyd's invitation offers the Prime Minister the opportunity to see how the Lloyd's market works. Lloyd's have also indicated three particular topics for discussion: the effect on Lloyd's of exchange rate changes; the prosecution of financial offenders; and prospects for trade with China. We also expect Lloyd's to mention freedom of trade in services in the European Community. From the Government's point of view, the lunch is a useful occasion to stress to Lloyd's that they must keep up the development of their self-regulation to eliminate abuses. Background notes on these and some additional issues are attached. A line to take is suggested below.

LINE TO TAKE: SPEAKING NOTES

GENERAL

Welcome this chance to see how Lloyd's works and discuss its problems. Lloyd's makes an important contribution to the national economy: Government therefore has an interest in its welfare. Impressed by Lloyd's efforts to make necessary reforms. But still concerned at the extent of speculation and adverse publicity about financial abuses. This is damaging not only to Lloyd's but to the reputation of the City and the credibility of self-regulation in the financial sector. Lloyd's deserve credit for the measures already taken, but cannot afford to relax. Must be seen to be tackling abuses. Some reforms still needed - eg control of reinsurance with connected companies, and "preferred underwriting". What steps do Lloyd's still expect to take?



EFFECT ON LLOYD'S OF EXCHANGE RATES

Interested to hear of Lloyd's special problems in relation to exchange rates and the capacity of the market, but not clear that the Government can do anything to help.

Commercial enterprises must adapt to market forces in this area as in others. It is primarily for Lloyd's to find solutions to their own problems. Not aware of any special problems for Lloyd's under UK legislation, but DTI would be glad to listen if Lloyd's think there are.

PROSECUTION OF FINANCIAL OFFENDERS

Government determined to crack down on financial fraud. The new Fraud Investigation Group, and the DTI proposals on regulation of financial services, show the Government's concern. But decisions on individual prosecutions must be left to the DPP in conjunction with the Law Officers. The Attorney General has emphasised his personal interest in these cases. Gathering evidence is bound to take time, especially when important witnesses and documents are abroad.

TRADE WITH CHINA

Wish the Chairman success on his forthcoming visit. Hope very much that Lloyd's will be able to take advantage of current expansion of Chinese insurance to increase the business they do with that market. Government always ready to help in those areas where it can usefully assist Lloyd's own efforts.

EUROPEAN COMMUNITY

FREEDOM OF SERVICES (IF RAISED)

Completion of internal common market in services, including insurance, is a UK priority. Made this clear in



Fontainebleau paper for other Heads of Government
/ "Europe the Future" /. Hope the European Court cases on
insurance will help in achieving Community insurance regime
which is UK's aim.

REGULATION OF FINANCIAL SERVICES (IF RAISED)

Lloyd's will not be covered by the proposed legislation on
financial services. However, if underwriting agents invest
other funds unconnected with the insurance business, we
think they should be treated under the financial services
legislation in the same manner as solicitors, accountants
and actuaries - that is, regulated by the Council of Lloyd's
under rules which will take account of the requirements of
the appropriate Board, unless the investment business
concerned is a significant part of their activities, in
which case they may need to seek separate authorisation.
Do Lloyd's see any difficulties?

TAXATION (IF RAISED)

Inland Revenue are bound to investigate possible under-
payment of tax. Government recognises the need for
insurers to maintain adequate reserves, but existing tax
law allows for this.

Insurance Division 1
Department of Trade and Industry
January 1985

lunch at Hayes.





BRIEF FOR PRIME MINISTER'S VISIT TO LLOYD'S,
FRIDAY 1 FEBRUARY 1985

BACKGROUND NOTES

EFFECT OF MOVEMENTS IN EXCHANGE RATES

1 The USA is Lloyd's largest market, and about 70% of Lloyd's business is rated in dollars. The high exchange rate of the dollar against sterling normally gives UK exporters of goods and services a competitive advantage. In so far as Lloyd's operating costs are sterling-based, this applies to them too. But Lloyd's, like other insurers, can only safely accept business up to a certain multiple of their capital base. In Lloyd's case this consists of mainly sterling assets, and the premium income ceilings are fixed in sterling. If business is already flowing at full capacity, Lloyd's cannot take advantage of the potential for an increase in business; indeed, the amount of business accepted may have to be curtailed. We understand there is already a serious capacity problem in the non-marine market. Lloyd's are looking at ways to relieve the pressure. This might have some technical implications for DTI supervisory purposes but we are not aware of any fundamental problems in legislation. DTI would be glad to discuss this with Lloyd's if they wish.

DISCIPLINARY CASES AND PROSECUTION

2 Lloyd's have completed much of their work on the investigation of major "scandals". The next step is to bring disciplinary proceedings against those individuals or firms within Lloyd's jurisdiction. Proceedings are completed in the Brooks & Dooley case, and in progress in the Howden, Minet and Multi Guarantee cases. Lloyd's intend to make full announcements of their findings and the actions taken. If, as expected, the main allegations are confirmed, the pressure will increase for the DPP to pursue criminal prosecutions. As Lloyd's well know, investigation of financial malpractice is very complex. It has taken Lloyd's themselves over two years to bring offenders to book. The standards of evidence needed to convince a jury in a criminal trial are even higher. The Attorney General has given public assurances that hee takes a personal interest in financial fraud cases.

TRADE WITH CHINA

3 The Chairman intends to visit China in April this year. Lloyd's does significant business with China at the moment, particularly in the reinsurance field, and relations between the UK industry and China are generally good (eg the Chinese state-owned company sends trainees to the London



Offices of Lloyd's Brokers; the Sedgwick Group have a representative office in Peking). With the current expansion of insurance business in China, Lloyd's clearly hope to expand their activities in that market. Lloyd's are in touch with the FCO and our Embassy in Peking about arrangements for the visit. We understand that the Chairman may seek the Prime Minister's advice on the general trend of relations with China, how Lloyd's activities fit into this, and how Lloyd's can best promote UK interests. There is little to say beyond encouraging Lloyd's to pursue their plans and keep in close touch with the FCO. The Government is aware of the desirability of strengthening insurance links with China and it is planned that an insurance broker should accompany Lord Young when he visits China in March.

From Sedgwick's

EUROPEAN COMMUNITY: FREEDOM OF SERVICES

4 Freedom of Insurance Services in the Community, that is freedom for an insurer to write insurance in a country without being established there, is a UK priority and an important element in the completion of the Community internal market in services. It is of particular importance to Lloyd's. Lloyd's constitution makes it more difficult for them than for companies to establish abroad, although they have done so in some Community countries including France and Belgium and are seeking to do so in Italy. The purpose of the proposed non-life insurance services directive is to facilitate the exercise of the Treaty right of freedom of services. The directive has made little progress in some nine years because we want a liberal directive and eight of our partners want a restrictive one. Negotiations on the directive are continuing but there are unlikely to be any developments until the European Court has given its judgments in the first two of four "co-insurance" cases that the Commission has brought against four other Member States (France, Denmark, Germany and Ireland). The cases are to be heard in March. The judgments might help our position if they provide a liberal interpretation of freedom of insurance services.

SELF-REGULATION (GENERAL)

5 Since the passage of the Lloyd's Act 1982 Lloyd's have taken important steps to improve regulation of the market. The Council has made major byelaws and regulations. The matters covered include improved accounting and auditing standards; proper disclosure of the financial interests of underwriting agents; stricter monitoring of premium income limits which limit the amount of business written; and detailed rules for the separation of brokers and syndicate managers, as required by the Lloyd's Act.



6 Lloyd's deserve credit for having done so much, in the past two years. But there are still important matters to be dealt with, including control or prohibition of reinsurance with companies owned or controlled by syndicate managers; tighter control of brokers (at present relatively unregulated); and prevention of "preferred underwriting", where a syndicate manager controlling more than one syndicate give preferential treatment to syndicates containing his own associates. (These are often small syndicates known as "baby syndicates"). Proposals have been made on all these topics, in response to known abuses, but action is still under consideration.

7 Some within Lloyd's are resistant to further changes because they fear the stifling of flexibility and competition which are Lloyd's greatest strengths. However, reform of the market is essential to restore Lloyd's reputation. Government takes an interest in progress because the national and commercial consequences of a breakdown in Lloyd's control of its market are incalculable.

THE CHIEF EXECUTIVE POST

8 Mr Ian Hay Davison was appointed Chief Executive and titular Deputy Chairman of Lloyd's after strong pressure from the Government and the Bank of England. His position is not always easy; his constitutional role in Lloyd's is weak and ill-defined. Last year there were rumours that he would resign by the end of the year. The crisis passed and he is now expected to stay for at least another year. The reform programme should then be near to completion, but there will still be a need for a high-calibre and independent-minded chief executive.

REGULATION OF FINANCIAL SERVICES

9 The Financial Services White Paper, published on 29 January, excludes non-life insurance from the scope of the proposed legislation because it is not commonly regarded or sold as investment. Under the proposals, the Secretary of State will delegate powers to practitioner based regulatory bodies. The arrangements recommended by the Governor of the Bank of England and the life insurance/unit trust industries envisage two boards - a "Securities and investment board" and a "marketing of investments board". The latter would cover marketing of life assurance and unit trusts. However, the legislation will not prevent delegation to a single body.



TAXATION

10 Lloyd's are in discussion with the Inland Revenue over the taxation treatment of underwriting reserves and other matters. The Revenue are currently enquiring into the computation of tax liabilities of Lloyd's underwriters for both past and future years. Lloyd's may argue that the Revenue should not be too restrictive towards reserving for unreported claims, which cannot be calculated with prevision. The present position is that reasonable estimates of outstanding claims are allowable for tax purposes but underwriters must be able to satisfy the Revenue that they conform to tax law.

Insurance Division 1
Department of Trade and Industry
January 1985