

Winding up my father's Lloyd's interests

Introduction

This note summarises my personal experience of winding up my father's Lloyd's interests when he died. I hope it will be useful to others facing a similar challenge. It is intended as a factual description prepared in good faith and it is not intended to provide advice or recommendations for anyone to rely on. I would recommend that any family in a similar situation obtain their own advice from accountants and lawyers who have the capability and experience to deal with the estate of a Lloyd's name. Being an informed client is, however, a good way to handle professional advice efficiently and control the cost.

My father died in March, 2004 and had been a Lloyd's name for over 20 years. Being an actuary, he was fully aware of the risks of participating in the market and how to handle them. It may be some comfort to those reading this note that the experience of dealing with the estate of a Lloyd's name has not been a horror story. The overall exposure of the estate to Lloyd's was capped within eight months after my father's death and all funds held at Lloyd's were distributed to the estate within a period of seven years after his death.

This note consists of a description of what I felt I needed to know about the Lloyd's market in order to deal effectively with my father's estate, followed by a summary of the process of administering the Lloyd's component of his estate. The contents are as follows:

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Lloyd's underwriting

Lloyd's has a good web-site (www.lloyds.com) containing information on how the market operates and a useful glossary of technical terms.

A **name at Lloyd's** is a private individual who underwrites insurance business in the Lloyd's insurance market. A key feature of names is that they have **unlimited liability** to any claims which they have underwritten. Most of what is involved in dealing with the estate of a Lloyd's name centres on capping this exposure and then unwinding it.

There are about 1,500 names at Lloyd's. They underwrite insurance in the market alongside private companies (whose liability is limited) and individuals underwriting via private companies; in fact, since March 2003 individuals have not been admitted to Lloyd's to underwrite as names on an unlimited liability basis. A name will participate in the market through a **Members' Agent**. On behalf of each name, the Members' Agent organises the name's participation in various insurance **syndicates** and so-called Members' Agent Pooling Arrangements (**MAPAs**) where the underwriting capacity of several names is pooled to enable them to participate in a wider range of syndicates than would otherwise be the case. Syndicates are usually referred to by numbers e.g. Syndicate 666. MAPAs have 4 digit reference numbers beginning with a 7 e.g. 7004.

As the term implies, syndicates are groups of both names and companies underwriting insurance in the Lloyd's market. Each syndicate will insure against particular classes of risk such as marine, motor, aviation, or accident & health, sometimes localised to particular geographic areas (e.g. U.K., Europe, U.S., rest of the world). A Members' Agent will organise a name's participation in syndicates according to the name's preferences to underwrite particular types of business and, at the same time, spread risk.

An important class of insurance is **reinsurance** which accounts for about half the underwriting business written at Lloyd's. Reinsurance is the practice of insuring an insurer against particular types or amounts of underwriting loss. For example, an insurance company providing motor policies may reinsure or 'lay off' its risk of all car thefts or its risk of all accident claims above, say, a limit (**excess**) of £10m. An important type of reinsurance for Lloyd's names is **stop-loss** reinsurance, where a reinsurer insures some or all of a name's losses above a stated multiple of the name's underwriting income. As discussed below, reinsurance also plays an important role in closing out a syndicate's exposure to any further claims after a given period of time.

Each syndicate appoints a **Managing Agent** who manages the insurance business taken on by the syndicate. Managing Agents deal with **brokers** who shop around the market to find the best terms syndicates will offer to underwrite the risks their clients are seeking to insure. These terms will include **premiums** paid by the clients to the syndicates for accepting the risks.

To take an everyday example, if I want comprehensive insurance for my car, I can telephone Direct Line and get a quote. If instead I wanted to use the Lloyd's market to insure a fleet of cars, I would ask a Lloyd's insurance broker to arrange the cover. The broker would approach the Managing Agents of the syndicates which specialise in motor insurance in the U.K. and obtain terms for comprehensive insurance of the fleet. I would then sign the acceptance form and pay the premium.

When a syndicate underwrites a risk in return for a premium there is generally one of two outcomes: either the risk does not crystallise and the syndicate makes a profit from the premium, or the risk crystallises and the syndicate has to settle a claim by the insured party to cover the insured loss. In some circumstances it is not known for some time whether there is going to be a claim. A third possible outcome is a disputed claim. The dispute may be either about the amount of loss that an insured party is claiming (e.g., the value of a car in the fleet that was stolen), or over whether the terms of insurance actually covered the loss claimed by the insured party (e.g. whether the insurance covered an accident involving a car that replaced a car stolen from the fleet).

If the syndicate has to settle a claim, it may have sufficient funds from the underwriting premium it has received to settle it. If it has insufficient funds, it will need to make a **cash call** on the members of the syndicate in order to settle the claim. Cash calls on syndicate members are made in proportion to their percentage participation in the syndicate's activities.

Lloyd's handles the financial administration of the syndicates' activities, receiving premium income, paying out on agreed claims, and collecting cash calls from names. It also handles the tax and regulatory issues arising from underwriting insurance in overseas jurisdictions and provides the key information required for names' tax returns. These functions are mostly carried out by Lloyd's **Members' Services Unit (MSU)**.

Funds at Lloyd's

It is important for the integrity and reputation of the Lloyd's market that names will always have sufficient funds to meet cash calls made by the syndicates so that syndicates can always settle valid claims. To ensure this, each Lloyd's name is required to (1) provide **collateral** which Lloyd's can in the first instance access and apply to settle a cash call if the name fails to meet the call, and (2) demonstrate that he has additional **eligible assets** (not including his home) to support his underwriting activities at Lloyd's.

The collateral can be in the form of either cash or approved investments¹ and these constitute a name's **Funds at Lloyd's** or **FAL**. The Funds at Lloyd's play an important role in the settlement of a name's estate. They can consist of a **General Deposit**, a **Personal Reserve Fund (PRF)**, and a **Special Reserve Fund (SRF)**². It is important to bear in mind that, while the name is the beneficial owner of the Funds at Lloyd's, Lloyd's has security over the collateral as a legal charge and a name's investments are registered as being held by Lloyd's Corporation rather than by the name. Lloyd's can activate its security to ensure that all dividend payments on the investments are paid into the name's Funds at Lloyd's instead of to the name. It can also use its Power of Attorney to sell the investments to provide cash to settle a name's liabilities.

Because the liability of a name at Lloyd's is unlimited, Lloyd's can pursue a name for all his assets to settle claims on behalf of syndicates, after the collateral and Funds at Lloyd's are used up, until he is bankrupt. By the same token, Lloyd's can pursue a name's estate for all the assets in the estate until all claims are settled, or until no assets are left.

¹ Shares, bonds, life policies

² The difference between Personal and Special Reserves is pretty technical and is not important for dealing with a name's activities once he has died. It relates to the tax treatment of underwriting profits

Allocated Premium Limit underwriting shares

There are solvency requirements (the “Capital Test”) which determine the amount of underwriting a name may undertake based on the amount of his Funds at Lloyd’s and additional eligible assets. For example, a name may decide he wishes to commit £250,000 of Funds at Lloyd’s to support his underwriting activities and have further eligible assets of £250,000. The solvency requirements would then determine that the name could accept a total of, say, £500,000 of underwriting premium in a year (roughly equal to the amount of Funds at Lloyd’s and additional eligible assets). This is the name’s **Allocated Premium Limit**. A name would then allocate this premium limit across the syndicates and MAPAs in which he wished to participate, say £50,000 to each of five syndicates and £250,000 to a MAPA which in turn would be allocated as participations across a range of syndicates. Each syndicate aggregates the allocated premium limits underwriting participations of each of its members to determine the **capacity** of underwriting business it can undertake in a year (i.e. the total amount of premium income it can receive in a year)³.

Accounting for underwriting profits or losses – ‘years of account’

For many insured risks, it is a straightforward matter to establish whether or not a risk has crystallised and whether there is going to be a claim. For example, it is easy to establish whether or not a car has been stolen or a house has burned down. Insurance where claims are usually made during or shortly after the period of insurance is often referred to as ‘short-tail’ business. For ‘long-tail’ business, such as product liability cover, claims may be made many years after the period of the insurance has expired. Claims from workers developing asbestosis are a prominent example of claims emerging long after the period of insurance. Claims can also be subject to long-running legal disputes.

To address this situation, underwriting syndicates at Lloyd’s aim to determine their profits and losses *after two years have elapsed following* the ‘**year of account**’ in which insurance business was written. This means that the profits and losses for the underwriting activities of a fictional Syndicate 666 in the year to 31st December, 2006⁴ (the 2006 account) are not finally determined until after the end of the year to 31st December, 2008.

By way of example let’s assume that, at the beginning of 2006, Syndicate 666 provided one year’s comprehensive insurance cover for a fleet of cars in return for an insurance premium of £100,000. If all went well, and Syndicate 666 only had to pay out £20,000 in claims settled in 2007 and 2008, it would in 2009 aim to report an £80k profit for the 2006 Year of Account (less the syndicate’s overheads, fees and administration expenses charged by Lloyd’s). The profit would then be available to distribute to syndicate members in proportion to their shares of the syndicate’s underwriting capacity (although the Managing Agent might decide to retain part of the profit to enhance the syndicate’s reserves and its ability to write future business).

In reporting underwriting profits, syndicates will as a matter of prudence aim to take into account all likely claims and certainly all the claims they know about. However, there is always the possibility that a delayed claim will arise. For example, it could emerge after several years that a driver of one of the cars in the fleet insured by Syndicate 666 was responsible for an accident. After the end of 2008, Syndicate 666 will aim to address this risk by reinsuring the risk of any further claims arising from the business which it wrote in 2006, for a premium of, say, £5,000. From then on, the reinsurers will take on the risk of any

³ It can increase the amount by re-insuring the risks it has taken on

⁴ Years of account are calendar years to 31st December

further claims. Once the risk of residual claims is reinsured, the 2006 Year of Account is 'closed' and the syndicate can make a final report on its underwriting profit or loss for the year. The reinsurance to achieve this is called 'reinsurance to close'. Until the syndicate is closed, the year of account is 'open'.

Generally the same syndicate will reinsure the risk the syndicate took in an earlier year: e.g. the participants in Syndicate 666 in the 2007 Year of Account will, in return for a premium, take on the risk of any further claims arising from the business they wrote in the 2006 Year of Account. This is because the syndicate which underwrote the original business will inevitably be in the best position to assess the likelihood of any further claims arising.

The illustrative example above is summarised in the following table:-

Syndicate 666 – example of a profitable underwriting result			
2006	2007	2008	May 2009
The 'Year of Account' in which the insurance business is written	2006 Year of Account is 'open'	2006 Year of Account is 'open' but will aim to 'reinsure to close' at the end of the year	Two years have elapsed since the 2006 Year of Account. Syndicate 666 publishes its accounts for the Year of Account, which is now closed
Syndicate 666 receives £100k underwriting premium for comprehensive insurance of the car fleet	Claims of £20k settled	At the end of 2008, Syndicate 666 'reinsures to close' the risk of any further claims arising from the 2006 Year of Account by paying a premium of £5k to Syndicate 666 for its 2007 Year of Account	Syndicate reports a final underwriting profit of £75k: £100k premium income less £20k in settled claims and £5k to 'reinsure to close' the risk of any further claims. Up to £75k cash (less overheads and expenses) is available to be distributed to syndicate members in proportion to their underwriting participations

This is clearly an upside outcome. There is of course a downside outcome that the car fleet has a catastrophic year which results in £250,000 of claims having to be settled in 2007 and 2008. Syndicate 666 then has to finance any deficit beyond the underwriting premium it has received with cash calls on the syndicate members. Normally it would start making these calls in 2007 and 2008 when it can estimate the size of the liability, with any balance to be collected in 2009. Once the claims are settled with the cash calls from the syndicate members, Syndicate 666 would reinsure to close its 2006 Year of Account as before:-

Syndicate 666 – example of a loss-making underwriting result			
2006	2007	2008	May 2009
The 'Year of Account' in which the business is written			Syndicate 666 publishes accounts for the 2006 Year of Account
Syndicate 666 receives £100k underwriting premium for comprehensive insurance of the car fleet	Claims of £100k settled, financed out of premium received Further claims expected and syndicate makes a £100k cash call on syndicate members in proportion to their underwriting participations	Further claims of £150k settled and additional £55k cash calls on syndicate members to fund balance of expected remaining claims As before, Syndicate 666 pays £5k to 'reinsure to close' the risk of any further claims arising from the 2006 Year of Account, which is then 'closed'	Syndicate 666 reports an underwriting balance of a loss of £155k: £100k premium income less £250k in settled claims and £5k to 'reinsure to close' the risk of any further claims

The one merit in this outcome is that Syndicate 666 can at least establish certainty and close out the underwriting business it took on in 2006. In the worst case, there may still be significant uncertainty surrounding the size of any further claims at the end of two years after the 2006 Year of Account, making it impossible to 'reinsure to close'. In this event, the 2006 Year of Account for Syndicate will remain open and will be said to be in 'run off': each year it will continue to make additional cash calls on members until all claims are agreed and settled. Only when a reasonable degree of certainty can be established over the remaining liabilities will Syndicate 666 finally be able to reinsure to close its 2006 Year of Account:-

Syndicate 666 – worst case underwriting result: syndicate in run-off				
2006	2007 – 2008	May 2009	May 2010	May 2011
The 'Year of Account' in which the business is written		Syndicate 666 publishes accounts for the 2006 YoA, and reports it remains open	Syndicate 666 reports further losses for 2009	Syndicate 666 reports that the 2006 Year of Account is finally closed at the end of 2010
Syndicate 666 receives £100k underwriting premium for comprehensive insurance of the car fleet Fleet has a run of bad accidents	Claims of £250k settled, financed out of premium received and cash calls Continuing uncertainty means it is not possible to reinsure Syndicate 666 to close its 2006 YoA	Syndicate 666 in run-off for the 2006 YoA Continues to make cash calls each year to provide for claims which emerge £200k cash call in 2009	Another cash call of £50k in 2010 Once a reasonable degree of certainty can be established, Syndicate 666 reinsures to close the risk of any further claims arising from the 2006 YoA	Overall, Syndicate 666 experienced an underwriting loss of £405k: £100k premium income less £500k in settled claims and £5k to 'reinsure to close' the risk of any further claims

Practitioners in the Lloyd's market often refer to a Year of Account as being 'naturally open' for the first three years and thereafter as being 'open' when there is a reasonable expectation that it will be reinsured to close in due course and 'in run-off' when the prospects of a reinsurance to close are less certain. There is in some cases an even 'worse than worst' outcome where a syndicate's losses are so severe and its record so bad that existing syndicate members are not prepared to support the syndicate writing new business and new members are not prepared to join the syndicate. The syndicate then ceases to trade and is said by practitioners to be "orphaned", continuing to make calls on members for the Years of Account in run-off. It may be some time before the syndicate demonstrates the necessary stability to reinsure to close, if ever.

An important feature of reinsurance-to-close premiums paid from one syndicate year of account to another is that generally they must be set at a level where neither party expects a profit or a loss from the transaction. However, they almost certainly will not prove to be exactly the right amount and will either turn out to be too little or too much. With complicated insurance catastrophes it may take some time to get to a position where a "true and fair" reinsurance-to-close premium can be determined, which is another reason why some syndicates can remain open for a number of years after the usual three year accounting period.

In its 1990s restructuring, Lloyd's set up a reinsurance operation called **Equitas** to reinsure to close all non-life syndicates for the 1992 and prior years of account. This had the important consequence of wiping the slate clean for all non-life underwriting business written at Lloyd's up to 1992. Some people were sceptical that Equitas would be able to meet all the claims made on it. However, in a transaction announced in October 2006, Warren Buffet's Berkshire Hathaway insurance group agreed to reinsure all of Equitas's liabilities with some \$7 billion of reinsurance cover and to take on all Equitas's staff and operations to conduct the run-off of its liabilities. The transaction completed in 2007.

Lloyd's reporting of underwriting results: preliminary results, Consolidated Personal Account, Cash Statement and forecasts

In line with waiting two years after the year of account in which insurance business is written before reporting the underwriting result, the Managing Agent for each syndicate issues in April of each year **preliminary results** for the year of account *three years previously*. (For example, in April 2009 it reports preliminary results for the 2006 year of account.) The Managing Agent also includes the last year's results for any *earlier* years of account which

are still in run-off (in April 2009, the 2008 results for years of account prior to 2006). Based on this, the Members' Agent⁵ sends each name a **preliminary result** and an estimate of either cash calls or cash to be distributed. This communication also includes a forecast of the emerging position for the naturally open years of account, i.e. the 2007 and 2008 years of account that have not completed their three year accounting cycle.

In May, Members' Agents send each name a **Consolidated Personal Account** which reports the results of the syndicates in which the name participated as at the previous 31st December and confirming the preliminary results notified in April, with a booklet of guidance notes on interpretation. The first item in the Consolidated Personal Account is the 'Underwriting Balance' which the guidance notes explain as follows (using the 2006 Year of Account and the Consolidated Personal Account to be published in May 2009 as an example):-

"the share of net premiums receivable⁶, reinsurance to close premiums received⁷ or (for 2005 and prior run-off syndicates) the amount retained to meet all known and unknown outstanding liabilities as at 1st January 2008⁸, less net claims and reinsurance to close premiums payable⁹ or (for prior run-off syndicates) the amount retained to meet all known and unknown liabilities as at 31 December 2008⁸"

A basic understanding of the 3-year accounting approach and the practice of reinsuring to close (with some syndicates left to run off) makes the meaning of this key item in the statement easier to grasp. Essentially it is a combination of (1) the result of the Year of Account three years previously for the syndicates which have closed, and (2) the latest year's results for the Years of Account in earlier years which have not closed (are still in run-off).

The next part of the Consolidated Personal Account details the expenses incurred by the syndicates and Lloyd's, and some deductions for overseas taxation. The bottom line is a 'net result for the period'. Various adjustments (described later) are made to this result to arrive at a 'net amount to be carried forward to the Members' Agent's distribution cash statement'.

The **Cash Statement** details the cash profits (in sterling and US dollars) which the name has earned from syndicates making profits less the cash required from syndicates making losses. It concludes with either a net cash profit to be distributed or a cash call, which the name is required to settle towards the end of June. If a year of losses is followed by a year of profits, it is possible that Lloyd's will agree to reduce the cash call for the loss-making year by advancing some of the cash that is expected to be distributed in respect of the profitable year. This is called a 'Continuous Solvency Transfer' and is also shown on the cash statement.

In September/October of each year, Members' Agents⁵ issue a further forecast of the emerging position for each name on the naturally open year of account (two years back) and a first forecast of the previous year of account (one year back). Forecasts for syndicates in run-off are produced each year in March/April and are discussed further below.

Various other reports on the underwriting business of each syndicate and MAPA emerge through the year together with sundry communications from syndicates which have encountered serious underwriting losses and/or are in run-off. Lloyd's also issues valuations of a name's Funds at Lloyd's after each year end and statements showing all the cash movements in the Funds at Lloyd's every six months.

⁵ or LMAS, the Members' Agent for names who have resigned from Lloyd's or who have died (see below)

⁶ For the 2006 year of account

⁷ Premiums received to reinsure syndicates so that they can close out earlier years of account

⁸ Balances from cash calls held at the beginning and end of the year to meet claims of syndicates in run-off

⁹ Principally to reinsure to close syndicates activities for the 2006 year of account

What happens following the death of a name

When my father died, the key issue relating to his Lloyd's interests was the exposure of his estate to unlimited liability. Although most syndicates in which he participated would be reinsured to close two years after his death, a number would inevitably remain in run-off. These would already have made cash calls to cover all expected liabilities but there remained the possibility that further claims would emerge, particularly from syndicates with large and uncertain liabilities which prevented them from reinsuring to close. There was also exposure to the (remote) risk that Equitas might be unable to settle all the losses which it had reinsured.

The problem for the executors of the estate of a Lloyd's name is that they may incur personal liability if they distribute the assets of the estate and there then prove to be insufficient assets left to meet any Lloyd's liabilities which subsequently emerge. The rest of this note describes how the executors dealt with this in my father's case.

Initially following death

The first thing that happens once the death of an active name is notified to Lloyd's by his Members' Agent is that his underwriting participations in each syndicate are cancelled: the name receives no share of underwriting income and incurs no liabilities for the year of account in which he dies. This means that:

- the last year of account in which the name will have an underwriting exposure is the year to 31st December before his death
- hopefully, most of the underwriting exposure in that year of account will be reinsured to close at the end of the year following the name's death. From then on, the name's entire underwriting exposure will be to the remaining syndicates in run-off
- the Consolidated Personal Account and supporting information issued in May, two years after the year in which the name died, will show the extent to which it has been possible to reinsure to close the last year of his underwriting exposure

Following my father's death I met with his Members' Agent who briefed me on the status of his underwriting activities, explained a number of points which are included in this note, and provided me with a statement of my father's Funds at Lloyd's among other useful information. He also explained that my father's Lloyd's affairs would from then on be handled by **LMAS** (Lloyd's Members Agency Services), which is an administrative arm of Lloyd's which handles the affairs of resigned or deceased names if they have an Estate Protection Plan (described below). Further information on LMAS can be found on its web-site – www.lmas.co.uk – and it publishes a useful periodic newsletter which is also on the web-site. In due course the Members' Agent supplied LMAS with a CD-ROM of all the information relating to my father's underwriting activities.

Auction of capacity

In good years, the right to underwrite business at Lloyd's has value, rather like a trader's pitch in a street market, and names can sell their rights to participate in syndicates in **capacity auctions**. These take place in September and November. Following a name's death, LMAS or the name's Members' Agent will arrange for the underwriting capacity of a deceased name to be auctioned and remit the proceeds to his Funds at Lloyd's deposit account. If a name dies late in the year (after these auctions have taken place) the capacity will revert to the

Members' Agent and no value will accrue to the estate. For this reason, my father left a note in his Lloyd's papers to recommend that his Members' Agent should be contacted as soon as practicable after his death. This was a good idea.

Dividends

Following my father's death and the transfer of his underwriting affairs to LMAS, Lloyd's activated its power of attorney over the investments in his Funds at Lloyd's to mandate that all dividend payments should be paid into his Funds at Lloyd's deposit account. This was part of a process to ensure that all value arising from my father's assets was held within Lloyd's to settle any potential liabilities – but the family was not given notice that it would happen. At the time this unexpected action seemed rather abrupt. However, the eventual impact was immaterial as the investments were soon sold, as explained below.

Grant of probate

In order to apply for a Grant of Probate, the lawyers needed a valuation of the assets and liabilities of my father's Lloyd's business. This was simply achieved by providing a valuation of his Funds at Lloyd's as at the date of his death and a valuation of his open years of account¹⁰. These were both provided by LMAS. I also provided the £ and \$ bank balances of an account which my father's members' agent used exclusively for his Lloyd's business.

Executors should check with LMAS which Lloyd's entities need to be sent copies of the Grant of Probate when it is issued and whether Equitas should be sent a copy.

Dealing with unlimited liability: the Estate Protection Plan

Like, I assume, the majority of Lloyd's names, my father took out an **Estate Protection Plan** policy with **CentreWrite Limited**, a subsidiary of Lloyd's. The purpose of such a plan is to reinsure the estate of a Lloyd's name against any losses above a certain limit – the 'excess'. In my father's case, the annual premium was under £1,000 and the excess (which would change from year to year) was:

- a minimum level which was more or less equal to my father's Funds at Lloyd's, *plus*:-
- 20% of my father's participation in syndicates which were open in the year in which he died, capped at a maximum of 10% of his Allocated Premium Limit for the three years of account before the year in which he died.

The maximum excess calculated on this basis was significantly higher (by some 60%) than the Funds at Lloyd's. While the family could accept the need to leave in Lloyd's the capital already committed by my father, to fund the minimum level of the excess required, the prospect of putting new money into Lloyd's was, to put it mildly, not attractive given the family's extreme nervousness about anything to do with Lloyd's. My father's Members' Agent negotiated with CentreWrite to reduce the excess to an amount just above the value of my father's Funds at Lloyd's. This was a hugely important step for the family's peace of mind and made the administration of the estate very much easier.

The Estate Protection Plan contained three straightforward administrative conditions which had to be satisfied:-

¹⁰ This can be prepared on an actual or estimated basis, which can be discussed with LMAS

- the death of the name must be notified to CentreWrite within 30 days
- a copy of the Grant of Probate must be sent to CentreWrite within 30 days of issue
- LMAS must be appointed as the deceased name's members' agent (which the Members' Agent arranges automatically).

The excess under the Estate Protection Plan policy

Inevitably, the value of investments in the Funds at Lloyd's will fluctuate with the stock market. However, it was important for the administration of my father's estate that the excess under the Estate Protection Plan should be held entirely in cash deposits so that a market fluctuation could not possibly reduce the coverage of the estate's liabilities.

For this reason, the executors arranged to sell the investments in my father's Funds at Lloyd's. We had advice from my father's accountants that the base cost of the investments was their valuation as at the date of my father's death and that the capital gain was therefore minimal. As explained above, Lloyd's has security over the investments and they are registered in Lloyd's name, so the executors needed to set up a dealing arrangement with a broker using a letter of appointment approved by Lloyd's (to ensure that the proceeds of sale were paid to Lloyd's and remained within its security). The broker also needed to have a separate 'master agreement' with Lloyd's. Any broker that has acted for Lloyd's names will already have such an agreement in place and be familiar with the letter of appointment. (We used NCL Smith & Williamson who had previously handled all my father's share sales and purchases.) LMAS itself needs to handle the redemption of any unit trusts, in response to a written instruction from the executors.

The investment sales required quite a bit of paperwork but the process was reasonably straightforward and within two months of the Grant of Probate, my father's Funds at Lloyd's were held completely in cash, including the proceeds of two life policies that he had assigned to Lloyd's. The Funds at Lloyd's were also increased by some dividends and the auction of his underwriting capacity. The excess under the Estate Protection Plan was soon covered and the Funds at Lloyd's deposit account began to accumulate surplus funds above the excess.

The next steps were to extract the surplus for the estate and to distribute the rest of the estate to the beneficiaries without putting the executors at risk of personal liability.

Dealing with executors' personal liability: the Re Yorke application

Following the issue of the Grant of Probate (or Letters of Administration), executors will want to make a distribution of assets as set out under the terms of the name's will. However, the executors of an estate could become personally liable if they distributed all the assets of an estate only to find that there was a significant Lloyd's liability to settle. This could happen if the value of investments in the Funds at Lloyd's fell below the excess under the Estate Protection Plan policy (as a result of stock-market fluctuations), or in the unlikely event of a failure of CentreWrite or Equitas.

To address this, there is a legal procedure (known as a 're Yorke application' or 'Yorke Order'¹¹) by which the executors can obtain a Court order permitting them to distribute the estate without the risk of personal liability if they can demonstrate that all reasonable steps

¹¹ Named after a test case in 1997 involving a Lloyd's name (Yorke) in which the procedure was established

have been taken to cover off its Lloyd's liabilities. In my father's case the application proved to be straightforward. It was handled by the lawyers to the estate (Speechly Bircham) and required a standard 'sufficiency of funds' letter which I obtained from LMAS confirming that all my father's Lloyd's liabilities had been satisfactorily covered off. This in turn depended on (1) the existence of the Estate Protection Plan policy *with the excess covered entirely in cash*, and (2) Equitas's reinsurance of all pre-1992 Lloyd's liabilities. Neither I nor my father's executors needed to attend the hearing.

The Yorke Order was obtained some three months after the Grant of Probate and eight months after my father's death. The executors of my father's estate trustees were then free to administer my father's estate according to the terms of his will without any risk of personal liability, even if the excess required for the Estate Protection Plan policy was depleted by cash calls. The assets of my father's Lloyd's business effectively passed in trust to the next generation free of inheritance tax since they qualified for relief as business assets.

There are two observations to make at this point. Firstly, moving as quickly as we did minimised the risk that the Funds at Lloyd's would be less than required for the excess under the Estate Protection Plan policy, either due to stock-market fluctuations or because of emerging cash calls by syndicates to fund losses. Secondly, the Re Yorke application was a legal mechanism to protect the executors of the estate from personal risk. As one executor was my elderly widowed mother and the other was a family friend, there were very good reasons to put this protection in place. However, I am aware of another name's family who took the decision that a Re Yorke application was not necessary because of the level of funds retained within the estate.

Getting money out of Lloyd's and Exeat policies

Once the full amount of the excess under the Estate Protection Plan policy was funded in cash, the executors provided LMAS with a standing instruction (in writing) to transfer all surplus funds which accrued in the Funds at Lloyd's deposit account to an account nominated by the executors. The surplus funds arose principally from underwriting profits as the market improved after 2001, sundry payments from his underwriting, and deposit interest. LMAS also converted all dollar receipts into sterling prior to transfer. Every six months, LMAS sent the executors a Cash Movement Statement showing all movements in the Funds at Lloyd's including funds released to the estate.

Although the bulk of a name's underwriting business will be reinsured to close some two years after his death, there will inevitably be years of account for some syndicates remaining in run-off. While they may emanate from a small proportion of a name's underwriting activities, they will by their nature be years of account where there are problems in estimating future liabilities, preventing them from being reinsured to close. As a consequence, LMAS will not release the excess under the Estate Protection Plan until all the years of account in run-off are finally reinsured to close. In my father's case, this led to the only major investment judgement which the executors needed to make in relation to Lloyd's: whether to wait until all the syndicates in run-off had closed, or purchase an **Exeat policy**.

Similar to an Estate Protection Plan, an Exeat policy reinsures the estate against all further losses arising from syndicate years of account in run-off. Purchasing an Exeat policy enables the executors to release the balance of Funds at Lloyd's to the estate. The policy in effect draws a line under any further involvement with Lloyd's. CentreWrite issues quotations for Exeat policies but only when an estate's Lloyd's exposure has reduced to syndicate years of

account in run-off. This means that the first quotation will be received by a name's estate two years after the name's death. The quotations are normally issued in July of each year. The issue for executors and beneficiaries is how to assess this quotation, which depends on the underwriting position of syndicates in run-off and whether any further claims emerge.

Reports from syndicates in run-off

Syndicates in run-off publish reports on their underwriting exposures which are collated into a Run-Off Syndicates Report issued in March/April each year. (During the year LMAS will also pass on any announcements made by syndicates on developments in settling years of account in run-off or on any significant improvement of worsening in their claims position).

As described on page 7, the Consolidated Personal Account shows the 'Net result for the period' i.e. the net underwriting result for the year of account, which is then subject to a number of adjustments to arrive at the amount of either a cash call or cash distribution. These adjustments are explained in detail in the guidance notes but arise largely from syndicates in run-off and consist principally of:

- cash calls required by syndicates in run-off to fund losses
- the movement in "uncalled losses"

"Uncalled losses" are underwriting losses which syndicates expect that they may have to settle but do not require cash calls at the present time to settle them. This may be because of uncertainty attaching to the underlying claims or because before there are uncertainties in what can be recovered from reinsurance.

For a number of reasons, the amount of cash that has been called in respect of a year of account in run-off may be more or less than the expected underwriting deficit. Firstly, as just described, losses may be 'uncalled'. Alternatively, the underwriting position of a year of account in run-off may have improved after a cash call has been made. This may happen if, for example, the syndicate is required to put up the gross value of a claim in dispute, or more is recovered from reinsurance than had been expected. There will also be some effects from exchange rate movements, particularly the £:\$ exchange rate.

The report on syndicates in run-off sets out the relationship between the expected underwriting losses of the years of account in run-off and the amount of cash that has already been called to meet them. For example, the report may make statements such as:

"Syndicate 666 was unable to close the 2002 Year of Account as at 31st December, 2006. The managing agent reports that the account deteriorated by 2.0% during the calendar year 2006. The deficit at 31st December 2006 is 32%. Cash calls of 50% have been made."

This means that the underwriting result for Syndicate 666 for the 2002 Year of Account worsened by 2.0% of the premium received by the syndicate for the year (so 2.0% of each member's premium limit allocated to that syndicate as explained on page 4). However, the total deficit of 32% is less than the cash calls which have so far been made, which equal 50% of the premium received. If the Year of Account were reinsured to close on this basis, there would be a distribution of cash back to the syndicate members equal to 18% of the premium received less the amount paid to reinsure to close. If a name's share of the syndicate's premium income were £10,000, the cash returned would be £1,800 (18% of £10,000) less a share of the reinsure-to-close (RITC) premium. Needless to say, it is important in interpreting

this report to have to hand the schedule of the premium allocated by the name to each syndicate year of account as explained on page 4. LMAS can of course supply this schedule if required.

The report could, however, make a statement for the ill-fated Syndicate 666 such as:

“Syndicate 666 was unable to close the 2001 Year of Account as at 31st December, 2006. The managing agent reports that the account deteriorated by 10.0% during the calendar year 2006. The deficit at 31st December 2006 is 32%. Cash calls of 20% have been made.”

If Syndicate 666 were reinsured to close on this basis, it would need to make a cash call on syndicate members equal to 12% of the Syndicate 666’s premium income received in the 2001 Year of Account, plus the cost of the premium required to reinsure to close. If a name’s share were £10,000, the final cash call would be £1,200, plus a share of the RITC premium.

LMAS will answer any specific queries about the report on syndicates in run-off, and are good at explaining matters in detail if required, but it is useful to have a prior understanding.

Exeat policy compared with waiting until syndicates in run-off reinsure to close

We received the first quotation for an Exeat policy two years after my father’s death when his estate’s Lloyd’s exposure had reduced to 29 syndicate years of account in run-off. The quoted premium amounted to just over 50% of the value of the Funds at Lloyd’s. Using the report on syndicates in run-off, together with a schedule of the shares of premium income in each syndicate¹², it was possible to calculate the balance of the cash called in respect of each year of account against the total amount of expected underwriting deficits (taking into account syndicates where uncalled losses were in some cases higher, and in other cases lower, than the cash called). The calculation showed that the total projected underwriting deficit exceeded the total amount of cash called by a small amount, equal to 6% of the Funds at Lloyd’s held as the excess for the Estate Protection Plan. This meant that if all the syndicates were reinsured to close on the basis of the projected underwriting deficits shown in the report, there would be a cash call of some 6% of the Funds at Lloyd’s plus a share of the cost of re-insuring to close each syndicate year of account. In addition there would be a small annual administrative charge from Lloyd’s Members Services Unit (see page 3) until all syndicates in run-off were closed. This compared with the Exeat policy premium amounting to just over 50% of the Funds at Lloyd’s which would need to be paid for the estate to exit Lloyd’s altogether.

In relation to Exeat policies, the LMAS website says:-

“In the event of the death of a name, it is possible for the Estate to purchase an Exeat policy at the appropriate time. The downside is that it is generally felt that syndicates would close naturally at a cost less than the Exeat policy quotation.”

The executors felt this assessment applied in the case of my father’s estate. Two years after his death, there were 29 syndicate years of account remaining in run-off. The received wisdom is that the deficit position of syndicates in run-off gets worse. However, two years later, 12 of these 29 years of account in run-off had been reinsured to close with the aggregate final loss a little better than projected two years before. This enabled the executors to

¹² Note that, in the case of a MAPA, the Run-Off Syndicates Report will report on each individual syndicate in the MAPA. However, rather confusingly, it shows the total premium allocated by the name to the MAPA and not the allocation to each syndicate year of account within the MAPA. This information may need to be obtained from LMAS to perform the calculation described here

negotiate with Centrewrite a reduction in the Funds at Lloyd's held as the excess for the Estate Protection Plan Policy.

Two further years later (six years after my father's death), all but two syndicate years of account had reinsured to close with the aggregate final loss less than originally projected; the final two years of account reinsured to close the following year. In the final analysis, all syndicate years of account had been reinsured to close seven years after my father's death at less than the originally projected loss, at which point all the remaining Funds at Lloyd's were distributed to his estate.

This experience may be atypical and other executors will need to make their own assessment of whether to purchase an Exeat policy, depending on the risks they perceive in the syndicates in run-off, and whether they can wait for the syndicates to close naturally. This may, of course, take some years as in my father's case. The LMAS April newsletter contains useful information on the prospects of closure for the syndicates which remain in run-off, and executors are likely to find it helpful in deciding whether to purchase an Exeat policy.

As an observation, one advantage often cited for participating in Lloyd's is the opportunity to shelter inheritance tax. This needs to be set against the time it is likely to take for a name's estate to get money out of Lloyd's (seven years in my father's case) or the cost of an Exeat policy, which may well amount to more than any inheritance tax saving.

Other matters

Tax and the CTA 1 and 2 forms

As well as producing Consolidated Personal Accounts for each name, Lloyd's also produces two important tax forms: CTA 1 ('Consolidated Tax Advice 1') and CTA 2. These forms are fairly self-explanatory with their guidance notes: CTA 1 records the profit or loss for tax purposes on a name's total Lloyd's underwriting activities in Part 1, broken down by each syndicate/MAPA in Part 2. CTA 2 provides details of non-syndicate taxable income and expenses. The CTA 1 is issued in interim form in May for the tax year that has just ended and is updated for the final position, usually the following January. The CTA 2 form is issued in June/July.

Although the CTA forms cross-reference each item to the boxes that need to be filled in a Lloyd's name's tax return, I preferred to pass them to my father's accountants (Day Smith Hunter), who compiled the tax returns for his estate. They could keep track of some fairly sizeable tax losses to carry forward and shelter profits which emerged from the 2002 and 2003 years of account. They were also able to answer one or two queries from the Revenue.

U.S. and overseas powers of attorney

LMAS also issues powers of attorney for executors to sign which appoint Lloyd's to handle dealings with U.S. and overseas regulatory and tax authorities as a result of the name's underwriting insurance in the U.S. and other overseas jurisdictions. The executors would otherwise have to deal with the U.S. tax authorities themselves and therefore, in my father's case, they had no trouble signing them¹³. For legal reasons, the powers of attorney can only

¹³ The U.S. power of attorney was, however, re-issued for signature because the executors signed a photocopy and not an original!

remain in force for one year and so have to be reissued and signed again each year. They have to be signed by all executors, with the signatures witnessed.

W8-BEN

The W8-BEN U.S. tax form is a withholding tax declaration which recipients of investment income from U.S. sources are required to complete from time to time. It is incomprehensible. After LMAS sent it to the executors to complete, I asked Lloyd's for guidance on how to fill it in. Lloyd's in turn had to ask its lawyers before they could explain which boxes to tick and it now circulates helpful guidance notes for its completion. The form needs to be signed by all executors but signatures do not need to be witnessed.

Litigation action groups

There are a number of law suits in connection with syndicates which incurred substantial losses and had stop-loss policies which proved insufficient to meet all the liabilities covered. As a consequence, my father's executors received a number of requests to contribute to the funding of litigation by action groups. We decided that contributing to these funds would be throwing good money after bad. With regard to settling stop-loss policies, litigation would delay settlement and the receipt of funds by the estate and we took the view that cash today was infinitely preferable to the highly uncertain prospect of more cash achieved through litigation tomorrow. A number of other factors gave us cause for concern: the two leaders of one action group ignored requests to cease calling my elderly widowed mother asking for funds. They stood to earn a 10% success fee, they were the only members of the action group's committee, and they could not be removed from the committee under the powers of the action group's constitution.

The family also received various circular letters from a group called RTY E&E. Of all the ancillary material received in relation to Lloyd's, this made by far the speediest journey to the recycling bin.

Association of Lloyd's members

The Association of Lloyd's Members is a trade association representing the interests of all Lloyd's names including those who have resigned or died. It has a web-site: www.alm.ltd.uk which is well worth browsing, particularly to follow the latest market issues. It also publishes a newsletter and has a particular category of membership for those dealing with the affairs of deceased names.