ALM

The Voice of Independent Capital at Lloyd's

ALMNews

Issue No 3 ■ June/July 2007

Double Your Return on Capital?

How profitable has Lloyd's underwriting been over the past 50 years and how profitable might it be in the future? A paper has just been published which attempts to address these issues.

Eminent economist and Lloyd's Name, Professor Tim Congdon, CBE, published a paper in June entitled 'How Profitable is Lloyd's Underwriting?'. Its most startling conclusion is "An equities-based investor who puts all his or her capital into Lloyd's as FAL should eventually double the return on capital". The 'Executive Summary' from the paper is reproduced below in full.

Executive Summary

- Over the past fifty years or so the average profit from Lloyd's underwriting has been 2% to 3% of capacity. Given a 40% ratio of FAL to capacity, that implies an underwriting return on capital of 5% to 7.5% a year.

- Lloyd's underwriting enables an investor to "use capital twice".

- The typical long-run real return on equities is usually cited as 5% to 7% a year. It follows that an equities-based investor who puts all his or her capital into Lloyd's as FAL should eventually double the real return on capital.

- Lloyd's underwriting is risky, while the volatility may have

continued on page 2 ☞

Equitas Return Premiums

Equitas has begun sending out return premiums to reinsured Names. Those Names who have only recently informed Equitas of their addresses should be receiving cheques shortly.

The amounts returned are modest, but highly significant, as they signal that reinsured Names have achieved practical finality. However, some thousands of reinsured Names have not been in contact with Equitas to give their contact details, so their cheques cannot be despatched. **ALM members should already have received cheques but, if they know any reinsured Names who may not have been in touch with Equitas, they could encourage them to write to Equitas Ltd, 33 St Mary Axe, London EC3A 8LL, and give an address to receive the return premium. Phone calls will not be accepted.**

Category B members, whose only exposure to Lloyd's is their open years, including in some cases 2005 and 2006, may find the articles with a pale blue background of particular interest.

Published by the Association of Lloyd's Members 100 Fenchurch Street, London EC3M 5LG
Tel: 020 7488 0033 Fax: 020 7488 7555 E-mail: mail@alm.ltd.uk Website: www.alm.ltd.uk

Double Your Return on Capital? ... continued from page 1

increased in recent decades. But - if underwriting returns are expressed relative to capacity – participation in Lloyd's is no riskier than investing in UK equities.

- The potential doubling of investment returns from participation in the Lloyd's market may seem remarkable, but it needs to be remembered that a 2% to 3% return on capacity implies that profit margins are wafer thin.

- The meaning of the 2% to 3% return on capacity is that, out of every $100 of insurance premiums, the capital provider receives only $2 or $3. The rest of the $100 is absorbed by policyholder claims, brokerage and other costs.

- Returns on Lloyd's underwriting are not correlated with those on UK equities (and almost certainly not with those on other equity markets either).

- Underwriting returns are increased by the selection of high-quality syndicates and by good decisions on timing (i.e., reducing underwriting in a "soft market" and/or ahead of major loss events). The advice of a members' agent can be invaluable here.

If you wish to obtain a copy of the full paper, you should contact the ALM office in the first instance.

Professor Congdon was a member of the Treasury Panel of Independent Forecasters (the so-called "wise men") between 1992 and 1997, which advised the Chancellor of the Exchequer in a successful period for economic policy. He became a Name at Lloyd's in 1991 and currently underwrites to a capacity of £5.3m.