

Insurance traditionally spreads the risk of financial loss across a large number of individuals or companies, each of whom faces a similar type of risk. Individuals and businesses may also face financial losses that are unique. A group of investors in a new movie may lose millions of dollars if production problems occur. An athlete's career and earnings will be lost if he or she suffers a major injury. The cargo of a large ship, a major entertainment event that is dependent on good weather, or a fundraiser that offers a large prize for a difficult accomplishment such as a hole-in-one at a golf tournament each presents a possible but reasonably unique risk for the investors or event planners. Those unique risks are difficult to insure and have resulted in the growth of the specialty risk market.

Lloyd's (also known as Lloyd's of London) is the largest source of specialty risk insurance in the world. Surprisingly, Lloyd's is not an insurance company or even an actual company by itself. Instead it is a market where companies and wealthy individuals invest money to insure unique risks. Insurance is provided through syndicates or groups of investors who pool their money to insure specific categories of risk. Today Lloyd's has 64 syndicates which specialize in areas such as aviation, catastrophes, and professional risks.

The organization began in 1688 when merchants, ship captains, and ship owners would gather at Edward Lloyd's coffee house in London. Since there was always a risk of loss to ships and cargos, groups formed to pool their money to cover potential losses. Rich investors called names were attracted to Lloyd's to speculate on marine insurance. They would put money into a pool that insured a specific ship and its cargo. They would make money if the cargo and ship were safe but would have to pay if loss or damage occurred. Until 1994, most of the capital for Lloyd's came from individual investors. Due to huge losses suffered in the early 1990s, Lloyd's began accepting members, or corporations, as investors. Today, members provide about 90 percent of the investment capital while names provide the remaining 10 percent. Among the companies that insure through Lloyd's syndicates are 85 percent of the Fortune 500 companies, the top seven pharmaceutical companies, and the 20 largest global banks. The organization accepted insurance premiums of £13.7 billion last year.

THINK CRITICALLY

Handwrite your responses in the space below; 2 sentences each.

1. Why is it difficult and more expensive to get insurance for unique risks? Since premiums are likely to be high for specialty insurance, why would companies and individuals purchase that insurance?

2. Why would names and members want to participate in one of Lloyd's syndicates? What information would you want to have about the syndicate and the risks before you would become an investor?

3. Why are the types of significant and unique losses described in the case such as a one-time entertainment event or the production of a movie difficult to insure?

4. What makes Lloyd's different in both organization and operations from traditional insurance companies? Why would a wealthy individual or corporation want to participate in a syndicate?

5. Insurance is offered to provide protection for pure risk, meaning there is no opportunity for financial gain. Do you believe the investments of the Lloyd's syndicates are pure risks or speculative risks? Justify your answer.

6. Why do you believe most of the investment capital in Lloyd's syndicates today comes from corporations rather than names?

7. What type of risks would you expect the Fortune 500 companies, global banks, and pharmaceutical firms to insure through Lloyd's that they would not be able to insure through traditional insurance policies?