Political Booknotes

Risky Business: An Insider's Account of the Disaster at Lloyd's of London
Martin Mayer and Elizabeth Luessenhop
Simon & Schuster, $25
By S.C. Gwynne

You may know Lloyd's of London as the venerable, old-line British insurance house where the employees wear red tailcoats with brass buttons and where policies are written on all sorts of oddball risks that no one else has the imagination to insure: Betty Grable's legs, Bob Feller's fastball, the Space Shuttle, offshore oil rigs, and the Dallas Cowboys. This is the quaint Lloyd's of commercial legend: the company that would insure anything, and make money on it; the company that, out of its own deep sense of honor and tradition, never failed to pay off a claim.

This is also the company that is now plunged into a desperate scandal that is already counted in the tens of billions of dollars. It may soon enough destroy one of the world's oldest and most successful commercial institutions. Thousands of investors have already been ruined, and the lawsuits, claims, and counterclaims against Lloyd's, its agencies, managing companies, and brokers have become thickly layered and intricately interlaced. How Lloyd's fell—from the world's most respected insurance underwriter in 1980 to the blundering scapegrace we see today—is the subject of *Risky Business: An Insider's Account of the Disaster at Lloyd's of London* by Martin Mayer and Elizabeth Luessenhop.

Luessenhop is indeed an "insider," one of the thousands of American sponsors of Lloyd's insurance syndicates who lost money, and she is out to expose the perpetrators. Martin Mayer is the veteran financial writer whose book *The Bankers* is one of the best primers ever written on the banking industry. At its best, *Risky Business* cracks along in a clean, friendly narrative style. At its worst, which is not infrequent, the authors indulge at length in the sort of adversarial and highly complex legal minutiae one might expect from an "insider" in several of the lawsuits against Lloyd's. But Luessenhop and Mayer do not claim to be neutral or objective; they aim to show how $29 billion in insurance liabilities got hung on 33,000 people who will never be able to pay them off, and how Lloyd's has lost enough to wipe out all of its profits since World War II. The tale, regardless of an occasionally bumpy narrative, is still riveting.

It begins with what most of us would consider financial legerdemain: the way wealthy investors made money by putting up the capital behind the insurance policies that Lloyd's wrote. The "Names"—as the investors are known—didn't really invest anything at all. They merely pledged their assets, while the assets themselves—stocks, bonds, or land—continued to make money. "The new Name very visibly got something for nothing," write Mayer and Luessenhop. "You, not the bank and not Lloyd's, continued to own the stocks and bonds or CDs you had deposited as collateral ... You continued to receive the dividends and interest on your securities, and if their price went up, you got the benefit. You kept your investments, and you made something extra by using them as collateral at the same time." In some years the income the Names received from Lloyd's actually exceeded their income on pledged investments. It was a classic double dip, one that the landed classes in England have found hugely profitable for several hundred years.

The only way Names could lose money was if their insurance syndicate was forced to pay out more in claims than it took in as premiums. That had happened so rarely, and the amounts involved were historically so small, that Names tended to forget the one annoying little clause in their agreement with Lloyd's. According to their agreement, they not only pledged specific assets, they also assumed "unlimited liability" for claims made against Lloyd's by its customers.

Unlimited liability is an interesting concept, particularly when applied to thousands of middle and upper-middle class investors from the United Kingdom, Canada, and the United States—including Supreme Court Justice Stephen Breyer—who became Names at Lloyd's syndicates that had insured such clients as industrial polluters and makers of asbestos. (Luessenhop's syndicate specialized in insurance for toxic waste, product liability, and malpractice insurance.) Unlimited liability means that investors personally have to make good on never-ending, multibillion-dollar claims against Lloyd's by victims of asbestosis, for example; it means that they are directly liable for every penny owed, even if it means sacrificing every piece of property they own. The claims, according to the authors, arrive in the form of urgent "cash calls" that continue until the Name is bankrupt. The Name can never leave the syndicate and is essentially forever liable (beyond death, as well, since estates are then raided to satisfy calls) for unlimited amounts of money.

Such calls began in earnest in 1991 and have continued unabated since then. In 1993, for example, Lloyd's had $4.5 billion in losses, all to be made good by the poor Names. At least 30 Names—and possibly many more—have committed suicide because of their losse. These losses were the outcome of imprudent risks—risks, as with asbestosis, that often resulted in claims over many years or decades.

These losses also arose from a "reinsurance spiral" that resulted in billions of dollars of liability. Reinsurance is typically bought by an insurance company wanting to lay off some of the risk it has taken; reinsurers themselves can then lay off the risk, ad infinitum, in a process called "retrocession." Lloyd's did this compulsively and incestuously, reinsuring itself through its own syndicates. Syndicates were even reinsuring each other. The problem is that, when a multibillion-dollar liability comes home to roost, it tends to endanger all the syndicates involved in insurance and reinsurance. The 1980s were unfortunately rich in the sort of catastrophes that create huge damages: earthquakes, hurricanes, air crashes, oil rig fires, and product liability cases. Lloyd's syndicates, in their Pollyanna-ish way, had jumped in to underwrite such policies with both feet and, as the bad news mounted (and their fees as well), steadfastly delivered only good news to their investors and sponsors. It was apparently in no one's interest to tell the Names what was going on.

This was all done after Lloyd's had been effectively removed from all outside regulatory supervision in the early 1980s in a way reminiscent of much of the banking and savings and loan industries in the U.S. In Lloyd's case it was even more extreme: The company was allowed to regulate itself.

As Mayer and Luessenhop tell it, Lloyd's losses were not simply a product of management stupidity or of a run of bad luck. The men who ran Lloyd's, they argue, knew precisely what was happening. They knew it so well, in fact, that in the 1980s Lloyd's managers actively recruited thousands of new Names to take on the older risks that had begun to appear quite dangerous, all the while taking fat fees and reserving the lower-risk business for themselves and other insiders. This has been the substance of many lawsuits, including one by 3,000 plaintiffs against a syndicate called Gooda Walker for a claim of $1.3 billion—the largest lawsuit in English history. Though the plaintiffs won that suit, none of them

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have recovered any money.

Though the worst of the liabilities seem now to be known, there is a serious question of whether Lloyd's can continue to exist. If it goes down, it will be yet another in a long line of victims felled by greed and stupidity. But above all Lloyd's stands as yet another monument to financial deregulation, another warning that even the most venerable financial institution in the world is not immune to the sort of excesses common in the latter twentieth century. If it can happen at Lloyd's, it can happen anywhere.

S.C. Gwynne is the Austin Bureau Chief for Time.

The Luck Business: The Devastating Consequences and Broken Promises of America's Gambling Explosion

Robert Goodman

Free Press, $23

By Joshua Wolf Shenk

The "nice" side of town in Atlantic City is a stretch one block wide and less than 10 blocks long. This is what tourists see: velvet-soaked casinos, a Boardwalk lined with shops and concession stands, faux-everything. The rest of the city is a ghetto—cracked concrete coated with broken bottles and refuse. With the exception of pawn shops, which are plentiful, storefronts are mostly boarded up.

Casinos were supposed to revive this faded resort town. Instead, they hastened its decline. Rather than acting like a sponge soaking up visitors' money, as in Las Vegas, Atlantic City's casinos became more like rats, gnawing away at the remains of small restaurants and hotels. Out-of-state magnates like Donald Trump built self-enclosed fortresses along the beach. Jobs went to out-of-staters, and the problems of gambling addicts and increased crime stayed right at home.

You might expect this story to serve as a cautionary tale for towns attracted to the flashing lights of slot machines. Instead, casinos are enjoying unprecedented popularity among politicians and urban planners. Cities in rural South Dakota and Colorado mining country, in Louisiana and dozens of other states, have turned to gambling for a jolt of economic energy. They keep chasing the dream of Las Vegas, only to find themselves in the nightmare of Atlantic City. The big-spending tourists rarely come. Little new money enters the economy. The money that is spent is diverted from other area businesses.

Why do so many towns—from New Orleans to Joliet, Illinois to Davenport, Iowa—keep falling into the gambling trap? As Robert Goodman explains in *The Luck Business*, it's not because citizens are clamoring for more opportunities to gamble. In fact, every state-wide referendum to expand gambling since New Jersey's in 1976 has failed. The casino boosters are the industry itself and its eager followers—politicians seeking quick-fixes for deep-seated economic woes (and, sometimes, campaign contributions as well).

The pattern is depressingly familiar. It starts with vast promises: "This may be as important to Davenport as the Bill of Rights and the Magna Carta," one Iowa official said of Davenport's first casino license. "Riverboat gambling will start a rebirth of Joliet's center," predicted that Illinois town's city manager in 1992. "It will save us five years in developing our downtown."

The cities spend millions in infrastructure—readying the docks for riverboats, building access roads, expanding water and sewer systems. Next comes a high-profile media spectacle as the ribbon is cut, and the first gamblers throw their dice. Finally, after the hype comes the crash of unrealized expectations. Consider the case of Joliet. Like Atlantic City, Goodman reports, the town saw "a continuing stream of day-tripping gamblers, who stayed at the casinos and then left." No hotel was built. No new non-casino businesses were created, with the exception of a single take-out coffee shop.

The country is paying a dear price for this failed experiment. The rush to build casinos—and the concurrent expansion of lotteries and electronic gambling—has led to an enormous growth in the number of Americans who gamble. In 1990, 46 million people visited casinos. In 1993, that figure was 92 million. The number of gambling addicts, whose enormous debts lead to crime and broken families, is exploding. The problem is bound to get worse as a generation comes of age in an era of state-sanctioned gambling.

After the introduction of casinos; Atlantic City saw its crime rate triple in just three years, South Dakota endured a huge increase in bankruptcies and divorce claims. Between 1991 and 1994 Louisiana suffered a fivefold increase in the number of people seeking help for problem gambling.

The crazy thing about this gambling epidemic—and this is why Goodman's book should be read by anyone concerned with the crisis in public life today—is that political leaders are actively worsening the crisis. Seduced by the promises of tourist money and hundreds of new jobs, politicians cheerlead for expanded gambling and abdicate any regulatory role in the process. With lottery advertising, state money is even pitched in to make gambling seem like harmless fun.

At one point, Goodman quotes a gambling magnate talking straight about his plans: "When we put 50 slot machines in, I always consider them 50 more mousetraps. You have to do something to catch a mouse. It's our duty to extract as much money from the customers as we can and send them home with a smile on their face."

As this book demonstrates, the mice these businesses catch aren't just gamblers. They are towns, states—even the country itself—that are paying the price for a failed public policy.

Jihad v. McWorld

Benjamin Barber

Times Books, $25

By Gareth Cook

Last year, I went to Middleboro, a small town in southeastern Massachusetts, to