

THE SURPLUS LINE ASSOCIATION
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September 1, 1987

No. 423

BULLETIN TO ALL MEMBERS:

RE: Security Program - Bulletins 400 and 176, Revised September 1, 1987

The original bulletin on the Security Program was No. 176 dated April 3, 1962. It was reissued under Bulletin 319 on October 4, 1971 and revised under Bulletin No. 400 on March 1, 1985.

Attached for your information and guidance is a copy of a letter from the Department of Insurance to the Association dated August 20, 1987 regarding "Specific Implementation of Association Bulletin No. 400" and a copy of Association Bulletin No. 176 revised September 1, 1987.

By said letter to the Association dated August 20, 1987, and pursuant to Section 1765.1 of the Insurance Code, the Commissioner has directed every licensed surplus line broker and special lines' surplus line broker to furnish to the Association, as agent for the Commissioner, specified information about all U.S. domiciled nonadmitted insurers used by such broker in the placement of California business, including individual syndicates of a U.S. Exchange facility, and has prescribed a security review procedure with respect thereto.

As pointed out in the Commissioner's letter, the participation of the Association in the security review procedure outlined therein will be purely mechanical and ministerial and the Association shall have no authority or responsibility for either the selection or rejection of any security.



A. D. Freeman, Jr.
Manager

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September 1, 1987

No. 176 - Revised September 1, 1987

BULLETIN TO ALL MEMBERS:

RE: SECURITY PROGRAM

INDIVIDUAL RESPONSIBILITY OF MEMBER TO THE PUBLIC. Section 1765 of the Insurance Code relating to the qualifications for a surplus line broker's license, and a special lines' surplus line broker's license reads in pertinent part as follows:

"(a) A license under this chapter shall be applied for and renewed by the filing with the commissioner of a written application therefor. . .

(b) . . . [T]he commissioner shall issue a license authorizing any applicant who is trustworthy and competent to transact an insurance brokerage business in such manner as to safeguard the interest of the insured, to act as a surplus line broker [or a special lines' surplus line broker]. . ."

ULTIMATE RESPONSIBILITY IS ON MEMBER. Section 1765.1 of said Code, relating to the authority of the Insurance Commissioner over the soundness of nonadmitted insurers in which surplus line risks may properly be placed, reads as follow:

"In addition to any other statements or reports required by this chapter, the commissioner may also address to any licensee a written request for full and complete information respecting the financial stability, reputation and integrity of any nonadmitted insurer with whom such licensee has dealt or proposes to deal in the transaction of insurance business. The licensee so addressed shall promptly furnish in written or printed form so much of the information requested as he can produce together with a signed statement identifying the same and giving reasons for omissions, if any. After due examination of the information and accompanying statement, the commissioner may, if he believes it to be in the public interest, order such licensee in writing to place no further insurance business on property located or operations conducted within or on the lives of persons residents of this State with such nonadmitted insurer on behalf of any

person. Any placement in such nonadmitted insurer made by a licensee after receipt of such order is a violation of this chapter."

It will be noted that neither of the foregoing sections requires or authorizes the Insurance Commissioner to approve a nonadmitted insurer prior to its use by a surplus line broker. No other provision of the Insurance Code or the Rules and Regulations of the Insurance Commissioner makes such a requirement. Therefore, there cannot be and is not either an "approved" or a "disapproved" list of nonadmitted insurers which, in general, are not directly regulated by the California Insurance Department. The law places the responsibility for the selection of nonadmitted security on the surplus line broker or special lines' surplus line broker, and the soundness of his judgment in making the selection of such security so as to "safeguard the interest of the insured" is one of the basic qualifications required for him to obtain and retain his license.

The authority of the Insurance Commissioner pursuant to Section 1765.1 is to require any surplus line broker or special lines' surplus line broker to furnish information about a nonadmitted insurer used by him as security. In the exercise of this authority, the Commissioner, by letter to the Association dated August 20, 1987, has directed every licensed surplus line broker and special lines' surplus line broker, to furnish to the Association, as agent for the Commissioner, specified information about all U.S. domiciled nonadmitted insurers used by such broker in the placement of California business, including individual syndicates of a U.S. Exchange facility. The Insurance Commissioner presently believes that the purposes of the statute can be achieved by following the procedures outlined in her letter to the Association dated August 20, 1987 and this Bulletin. This belief is subject, of course, to future review of results and possible amendments of procedures. It is emphasized again, as hereinabove pointed out, that the selection of security and the responsibility therefor rests with the surplus line broker or special lines' surplus line broker.

PROCEDURES REGARDING SECURITY. It is the desire of your Surplus Line Association to be of aid to its members in the gathering of information about nonadmitted security in the interests of their clients so as to help members to fulfill their responsibilities under the law. The purpose of this Bulletin is to outline the procedures of the Insurance Commissioner and of the Association (after full consultation with the Insurance Department) regarding the review and handling of questions concerning the security of foreign and alien nonadmitted insurers. Of course, the Insurance Commissioner may in specific instances feel it necessary to proceed independently under his/her statutory powers without following the procedures herein outlined, but in any such case, the Commissioner advises that he/she will notify the Association of his/her action.

These procedures are as follows:

1. Definition of terms.

- (a) Nonadmitted foreign company means domiciled in the United States, but not admitted in California.
- (b) Nonadmitted alien company means domiciled in a foreign country, but not admitted in California.

2. Procedure with respect to nonadmitted foreign insurers, including syndicate(s) of any U.S. Exchange facility.

Refer to those procedures outlined in the Commissioner's letter to the Association dated August 20, 1987 that is attached to Bulletin No. 423.

3. Suggested procedure with respect to nonadmitted alien insurers.

Contract and/or open market placements.

When contract and/or open market placements are entered into with companies, the companies should be reviewed by the surplus line broker at least concerning such elements as capital, surplus and business reputation before the company is used by him. The Department has advised the Association that in reviewing and evaluating nonadmitted alien security the broker should take into consideration, to the extent pertinent, the criteria for review and evaluation of U.S. domiciliary nonadmitted insurers outlined in the Department's letter to the Association dated August 20, 1987 that is attached to Bulletin No. 423, particularly the \$3,000,000 net worth minimum.

The surplus line broker should advise the Association office of the names and addresses of all alien security with which California business is placed. If there are no existing Association files on any of such company(ies) the surplus line broker should secure and file with the Association the latest annual statement. The best and latest financial information available should be obtained. The Association will endeavor to guide the members as to the pertinent information to be ascertained and filed.

It is generally recognized that in many open market placements with alien insurers, there is a capacity problem resulting in the need for an overseas broker to find additional companies in order to promptly provide full coverage for the risk and where it is not practical, before placement, to follow the information gathering procedures suggested herein. In such cases, filing of the certificate with the alien security shown thereon, or by copy of cover note attached, will be the only filing in which the use of such security is initially reported to the Association; however, financial information on such alien companies is to be filed with the Association after the broker has secured such information and completed his analysis. Similar filings annually are requested as long as the nonadmitted insurer is being used as security. The responsibility for the selection of the nonadmitted security used rests with the broker, and he should secure company financial statements for his analysis.

4. Association office to secure information annually from appropriate licensee.

The Association will secure information annually concerning the companies used as security and shall review this information, and may discuss it with the Insurance Department.

5. Information requested by, but not otherwise supplied to Association, is to be furnished by appropriate licensee.

In those cases where the Association requests information concerning a nonadmitted company and the information is not otherwise forthcoming, the licensee using that

company will be asked to secure the information and submit it to the Association. It is the responsibility of the licensee to secure information concerning nonadmitted insurers used as security.

6. Continued use of questionable security.

If the Insurance Department has reason to doubt the soundness of a company, it may direct the Association to advise the licensee using the company of the facts underlying this concern and that if there is continued use of the company the Department may take direct action with the licensee under Section 1765.1

7. Bulletin to all licensees concerning discontinuance of a company as security.

In order that all licensees may know that the Department has directed discontinuance of further use of a company, at the direction of the Department a bulletin from the Association will advise the licensee. The bulletin shall not reveal the names of any licensees who have used the company as security. The licensees shall take action to make certain that such companies are not used on California business in the future and, in the case of nonadmitted alien insurers, shall so notify their overseas brokers.

8. Direct notification by Insurance Commissioner in serious cases.

It is to be emphasized that where the information developed appears serious, immediate action may be taken by the Commissioner under Section 1765.1, possibly to include required cancellation of outstanding contracts of insurance under authority of Section 12928.5 of the Insurance Code.

9. Maintenance of files in Association office.

The Association files on security are to be available at all times for review by the Insurance Department. They are also available for the members and licensed special lines' surplus line brokers to review in the stamping office, or pertinent information may be furnished by phone to members and special lines' surplus line brokers.

No information on security will be released by the Association office to other than surplus line brokers, special lines' surplus line brokers and the Insurance Department. Questions by other brokers and insureds concerning security should be answered by the surplus line broker or special lines' surplus line broker involved.

DEPARTMENT OF INSURANCE

100 VAN NESS AVENUE
SAN FRANCISCO, CALIFORNIA 94102



August 20, 1987

Mr. A. D. Freeman, Jr., Manager
The Surplus Line Association of California
333 Market Street
San Francisco, CA 94105

SUBJECT: Specific Implementation of Association Bulletin
No. 400

Dear Mr. Freeman:

This Department has recently reviewed the Surplus Line Association Bulletin No. 400 (revision and restatement of Association Bulletin No. 176) dated March 1, 1985, as it relates to the procedures and responsibilities for selection of security employed for surplus lines exportations. In this context and for the purposes of this letter the term "security" means any U.S. domiciliary nonadmitted insurer, and also any individual syndicate of a U.S. Exchange facility.

In connection therewith, this Department concurs that it is the primary responsibility of the surplus line broker or special lines' surplus line broker to make both an initial and also an ongoing evaluation and monitoring of any security which he employs for surplus line exportation. This Department expects each licensee to obtain appropriate financial documentation and relevant operational information for evaluation of such insurer used so as to document and demonstrate his exercise of prudent, reasonable and competent judgment to safeguard the interests of his clients.

The recent proliferation of insolvency proceedings against insurers (both admitted and nonadmitted) is a matter of serious and increasing concern to the Department. So as to ameliorate such concern and in the exercise of the authority vested in the Commissioner by California Insurance Code Section 1765.1, effective September 1, 1987, the Department will require that the security review program utilized by surplus line brokers and special lines' surplus line brokers embrace the following procedures:

- I. To the extent the following documents have not heretofore already been filed, every surplus line broker and special lines' surplus line broker shall file the following type documents with the Surplus

Line Association of California as agent for the Insurance Commissioner in order to demonstrate financial stability, governmental regulation, and managerial competency and integrity of any surplus line insurer proposed for use by such broker:

- A. Three (3) years' Annual Statements and the most recent quarterly financial statement showing operations under the same management.
- B. Examination Report from regulatory authority not older than three (3) years.
- C. Independent Audit Report, if any, not older than one (1) year (audit of proposed surplus lines insurer only preferred).
- D. Most recent NAIC-IRIS test results and Examiner Team Report.
- E. A demonstration of a minimum of three million dollars (\$3,000,000) in capital and surplus reflected in its most recent Annual or quarterly Financial Statement.
- F. A demonstration of compliance with the seasoning requirements prescribed by Section 716 of the California Insurance Code for insurers seeking admission to California unless the non-admitted insurer meets the qualifications for exemption under subparagraphs (a), (b) or (c) of Section 716.

If any of this information is not available, it will be presumed that the broker is unable to demonstrate that a proposed security meets basic minimum evaluation standards for employment as a surplus line outlet. In any event, no broker shall use such security unless and until all the required information has been furnished to the Association pursuant to this Paragraph I.

- II. When the basic documentary filings and related requirements have been met, the Association shall review the information filed and prepare a summary in a format prescribed by this Department. The Association shall file such summary, when completed, with the Department for review and shall furnish a copy thereof to the sponsoring broker. After due examination of the Association's summary together


Mr. A. D. Freeman, Jr., Manager
August 20, 1987
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with any other relevant information available concerning a surplus line security, if the Commissioner determines that it is in the public interest, the Commissioner may order all surplus line brokers and special lines' surplus line brokers to place no further California insurance business with a specific non-amitted insurer.

- III. The Insurance Commissioner reserves the right to interpose objection to use of any surplus lines security at any time when and if it is considered in the public interest to prohibit further placements in such security.
- IV. The Surplus Line Association of California will update and maintain documents, summaries and related information pertaining to any surplus line security proposed or utilized. The Association may at any time discuss with the Department any information about any security.

The foregoing guidelines are designed to present a minimum monitoring program whereunder the sponsoring broker, the Association, and the Department of Insurance cooperate to bring about an informed review of every U. S. security employed for California exportation. Nevertheless, the ultimate responsibility for employment of any security rests exclusively with the placing broker; and the responsibility for the rejection of any security by the Department rests with the Department of Insurance. The participation of the Association as agent for the Insurance Commissioner in the security review procedures outlined herein shall be purely mechanical and ministerial and the Association shall have no authority or responsibility for either the selection or the rejection of any security.

Very truly yours,


JOHN J. FABER
Chief Counsel
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JJF:vjc

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