

THE SURPLUS LINE ASSOCIATION
OF CALIFORNIA

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April 12, 1988

Bulletin No. 426
Supplement to Bulletin No. 423

BULLETIN TO ALL MEMBERS

RE: Security Program - Bulletin Nos. 423 and 176 Revised April 8, 1988

Bulletin No. 423 was issued on September 1, 1987 accompanied by a letter from the Department of Insurance dated August 20, 1987 concerning the specific implementation of Bulletin No. 400 and a copy of Association Bulletin No. 176 - Revised September 1, 1987.

Subsequent to the aforementioned documents, the Department of Insurance has issued an additional letter dated April 8, 1988 relative to the specific implementation of Association Bulletin No. 423. A copy of this letter is enclosed for your information and guidance as is a copy of Association Bulletin No. 176 - Revised April 8, 1988.



A. D. Freeman, Jr.
Manager

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April 8, 1988

No. 176 - Revised April 8, 1988

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 be properly 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 letters to the Association dated August 20, 1987 and April 8, 1988, 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 letters to the Association dated August 20, 1987 and April 8, 1988 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 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 as modified by the Commissioner's letter to the Association dated April 8, 1988 that is attached to Bulletin No. 426.

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 letters to the Association dated August 20, 1987 and April 8, 1988 that are attached to Bulletin Nos. 423 and 426 respectively, particularly the \$2,800,000 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, CA 94102



April 8, 1988

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. 423

Dear Mr. Freeman:

You may recall that our letter of August 20, 1987, outlined Departmental guidelines for specific implementation of your Bulletin No. 400 relating to guidelines to be employed by your membership in the Security Review Program of nonadmitted insurers underwriting California business. These guidelines, designed for specific implementation on and after September 1, 1987, have been duly incorporated by reference into your Bulletin No. 423 of September 1, 1987, and distributed to your membership and special lines' surplus line brokers for their guidance in selection of security for the exportation of California risks.

The Department's guidelines were devised and determined on a reasonable and rational basis and are fully supported by statute (Insurance Code Section 1765.1). However, in order to provide equitable treatment and a reasonable transition period for the nonadmitted markets as well as adequate protection for policyholders, this Department believes that certain modifications to the Security Review Program for U. S. domiciled nonadmitted insurers and syndicates can be made at this time. These modifications may be expressed as follows:

1. The minimum capital and surplus guideline specified in subparagraph E of paragraph I of our letter to the Association dated August 20, 1987 is changed from three million dollars (\$3,000,000) to two million eight hundred thousand dollars (\$2,800,000). Any U.S. domiciled nonadmitted insurer or syndicate security which heretofore has been or currently may be or is proposed to be employed for surplus lines exportation but which does not have a net worth of at least \$2.8 million surplus as regards policyholders consisting of assets acceptable under the California Insurance Code is not acceptable for further or new

placements. It should be noted that letters of credit are NOT acceptable assets under the California Insurance Code. Therefore, any U.S. domiciled insurer or syndicate security must have a minimum policyholders' surplus of \$2.8 million if it is to be an acceptable surplus lines receptacle, whether it be a security previously in use, a security presently in use or a security proposed to be used.

2. Except as otherwise provided in Paragraph (1) hereof, and in respect only to any nonadmitted U.S. domiciled insurer or syndicate which was employed by any of your members or a special lines' surplus line broker to provide coverage for California policyholders and risks during the immediate past calendar year ending December 31, 1987, a surplus line broker or a special lines' surplus line broker shall have until year-end 1988 to demonstrate full and complete conformance by such nonadmitted security with the Security Review Program Guidelines announced effective September 1, 1987. Should full conformance with such guidelines effective September 1, 1987 not be achieved by year-end 1988, then the affected security presumptively shall be deemed no longer acceptable for further surplus lines exportation unless and until it attains such full conformance.

The Security Review Program effective as of September 1, 1987, and modified as of this date, is designed to assist surplus line brokers and special lines' surplus line brokers with minimum guidelines for evaluation of security used or proposed for use for exportation of California risks. Ultimate responsibility for selection of nonadmitted security rests upon the surplus line broker or special lines' surplus line broker and the evaluation and judgment employed in making the selection of security to safeguard the insured is one of the basic qualifications required for obtaining and maintaining a license. The exporting broker should bear such responsibility in mind at all times when selecting a security with which he/she/it places the California exportations.

Very truly yours,



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cc: Norris W. Clark, Chief
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Reinsurance Bureau