SLA

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OF CALIFORNIA

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BULLETIN #760

California v. Lloyd's

We have been requested by the Commissioner to ask the assistance of our members in this matter. Attached is basic background information about this lawsuit.

We need you to contact your Lloyd's policyholders to describe the situation brought about by the Department of Corporations' lawsuit. Explain that the Insurance Commissioner has joined with Lloyd's in opposing the Department of Corporations. Note that all 50 state insurance regulators have joined together with Commissioner Quakenbush in opposition. State that while we expect to prevail, the role of the policyholders is key. Policyholders themselves need to make a strong case to the press and to the state's political leadership.

For each Lloyd's policyholder that you speak with, ask for permission to use their name as a Lloyd's insured. Find out if they would be willing to make a public statement and whether they would contact the Governor or the Insurance Commissioner. Finally, find out if they would be willing to sign a statement that would become part of the litigation.

The attached form lists these items. Please copy the form and fill out one for each policyholder and immediately fax the completed form back to this office or to Mr. Jon Kaufman (who is in charge of Lloyd's public relations) of Solem & Associates at 415 788 7858.

EClark

Edgar S. Clark
Executive Director

ESC/ljl

Attachment

Brokers: Please complete a separate form for each policyholder.

Lloyd's Insured Contact Form

Name of insured entity ______________________________

Address ______________________________

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Contact person at the ensured: ______________________________

Phone: ____________________ Fax: ____________________

The insured is willing to do the following in support of Lloyd's efforts:

- ☐ Allow insured entity's name to be listed as a Lloyd's of London policyholder.
- ☐ Make a public statement which may be published on potential consequences if Lloyd's pool of premiums is frozen and claims cannot be paid.
- ☐ Call Governor Wilson on this matter.
- ☐ Write to Governor Wilson and Commissioner Quackenbush on this matter.
- ☐ File a statement in connection with Commissioner Quackenbush's intervention in the Department of Corporations' law suit.

Name of broker ______________________________ Date ____________

Agency ______________________________

Phone ____________________ Fax ____________________

Please return this form by fax to: Jon Kaufman, Lloyd's Public Relations
Solem & Associates
550 Kearny Street, Suite 1010
San Francisco, CA 94108

Phone (415) 788-7788 **Fax (415) 788-7858**

Background Information
March 22, 1996

CALIFORNIA BRIEFING PAPER

LLOYD'S OF LONDON

For the past five years, several hundred United States underwriting members at Lloyd's of London, called "Names," have been litigating with Lloyd's in an effort to avoid paying their insurance indemnity losses for claims to policyholders. Some Names in the United States have recently enlisted the assistance of some state securities commissioners in their behalf, arguing that membership at Lloyd's constitutes a security which was sold in violation of state securities laws.

The action by the litigating Names and state securities commissioners seeks to reclassify as a "security" membership in an insurance marketplace that has functioned in essentially the same manner for more than 300 years.

These actions could have very damaging impacts:

- They could prevent Lloyd's underwriters from paying valid insurance policy claims to tens of thousands of policyholders and injured claimants, including hospitals and government agencies as well as private businesses.

- They could prevent more than $4.5 billion of financial assistance from reaching various Lloyd's Names who have underwriting losses and are trying to meet their obligations. This financial assistance is part of Lloyd's efforts to restructure the insurance marketplace it regulates. The restructuring plan is known as "Reconstruction and Renewal."

- They could destroy an insurance market which has provided vital insurance protection in the United States for more than 150 years. Virtually every sector of the United State economy relies on the Lloyd's market for property and casualty insurance.

What is Lloyd's of London?

Lloyd's of London is an insurance market that through its members has provided critically-needed insurance protection to people, businesses, public institutions and governmental authorities around the world for over 300 years. This includes earthquake, hurricane, tornado, flood and other property catastrophe protection; hospital and doctors' coverages; protection for airports and mass transit systems; policies for lawyers, accountants and other professionals; and a myriad of other coverages. The Lloyd's market often provides coverages that are simply unavailable from traditional insurers.

The Lloyd's insurance market is immense. Last year, the total premium written in the Lloyd's market was $14.4 billion. Approximately 30 percent of the business placed at Lloyd's is from the United States. Approximately four percent of the Market's business comes from California.

The United States relies upon Lloyd's more heavily than does any other country in the world. In 1906, Lloyd's established its U.S. reputation by unconditionally agreeing to pay all policyholder claims arising from the San Francisco earthquake. Today, in California, more than 100 state and municipal entities are insured by Lloyd's Names, as are countless hospitals, schools and churches. The film, entertainment, aerospace, financial services and shipping industries are dependent upon Lloyd's insurance.

Lloyd's is the leading source of insurance of U.S. surplus lines business, with a market share of just under 20 percent (source: A.M. Best). Lloyd's is also one of the leading sources of reinsurance of U.S. business, with 15 percent of all business ceded to non-U.S. reinsurers in 1994 (source: National Association of Insurance Commissioners).

Lloyd's non-marine market has agreed to underwrite a significant portion (over $200 million) of the world's largest reinsurance program, which is being placed on behalf of the California Earthquake Authority. More than 60 Lloyd's syndicates are involved in the risk. Lloyd's participation demonstrates that the market continues to be a world leader in providing solutions to some of the most difficult problems of insurance and reinsurance.

Membership in Lloyd's is not a security.

At Lloyd's, individual members, called "Names", assume insurance risk for their own individual accounts. Every one of Lloyd's 30,000 Names, including 3,000 in the United States, acts as a sole insurer. The Name's own assets provide collateral for his or her underwriting obligations, and a Name assumes risk on his or her own account. Underwriting profit or loss is a Name's own and is not pooled or otherwise shared with others.

Individual Names underwrite up to a specified amount of insurance, based on their means and the collateral they provide, but losses are not limited to the amount of the collateral. As a part of becoming a member of Lloyd's, Names are very deliberately and carefully informed that they have unlimited personal liability for the risks they personally underwrite.

Going all the way back to its beginning, Lloyd's operated on a simple basic principle: Names could (and did) make profits on underwriting gains, but in return, they had unlimited personal liability for losses. It was only in 1993 that the option of limited liability underwriting was introduced through corporate, not individual, members.

What is the California Department of Corporations' litigation all about?

The California Corporations Commissioner recently filed an action against Lloyd's, claiming Names residing in California have been purchasing securities. This action flies in the face of history and law. California residents have been admitted as Names for over 20 years without the State ever applying the securities laws to those admissions. No amendments to California law make these laws applicable now.

The Commissioner's action seeks to require a California Superior Court to freeze policyholder funds held in trust and at Lloyd's, thus threatening the payment of claims to policyholders.

This action can only be understood within the context of the unprecedented string of natural and man-made disasters and the accompanying explosion of liability claims, many involving environmental and asbestos claims, in the United States. As a result, every major international insurer writing United States business faced significant underwriting losses, including Lloyd's. During the period, 1988-1992, many other strong insurers incurred significant losses, some stopped trading and others merged or were taken over. Lloyd's, too, experienced a five year period of adverse underwriting results.

Faced with this background of severe losses, some Names have sought to avoid their liabilities to policyholders by suing Lloyd's.

The Department of Corporations' action comes after five years of unsuccessful litigation by individual Names. These Names filed suits against Lloyd's seeking to rescind their membership contracts in various federal courts. These Names sued under a variety of theories, including state and federal securities laws, RICO and common law fraud. However, included in the Lloyd's membership documents, signed by each Name, is a provision requiring that any claims regarding Lloyd's membership be litigated in England under English law. As a result, Lloyd's has been successful in obtaining dismissal of suits based upon the Names' agreement to pursue their legal remedies in England (where Lloyd's Names have already commenced several litigations). These decisions were affirmed by four federal circuits courts of appeal (Second, Sixth, Seventh and Tenth), and three petitions to the United States Supreme Court were denied. In only one of these Names actions has Lloyd's not yet prevailed. This action, pending in Texas, is currently on appeal.

Having been told by the federal courts to pursue their claims in England, certain Names now have turned to state securities regulators, who they contend are not bound by the provisions of the Lloyd's membership contract. Lawyers representing these Names and some politically influential Names themselves have actively sought assistance from, and recruited state securities Commissioners in Arizona, Colorado, Illinois, Missouri, West Virginia and Ohio to pursue claims, alleging that membership in Lloyd's constitutes a security which has been sold in violation of state law. These claims are substantially similar to those initially alleged by the Names themselves in their own lawsuits but which were dismissed by the U.S. courts.

Impacts of the Department of Corporations' action, if successful.

In the case of California, the Department's action, if successful, would have a disastrous effect on the state, and the people and organizations that need and rely on Lloyd's protection.

The impacts of the Department's action are many, and include:

- The suit would create an absolute and unfair preference for Lloyd's Names over policyholders. Claims of policyholders would be placed in a lower priority than certain Names and their attorneys. Lloyd's strongly believes that the interests of policyholders come first.

- The freeze on all of Lloyd's assets would prevent claims payments in California and worldwide. Lloyd's has more than 19,000 California policyholders.

- If the State, in effect, freezes substantial assets committed to the satisfaction of Policyholder claims, Lloyd's position as an accredited reinsurer is threatened. Many insurance companies in the State risk insolvency or some financial impairment. [The California Insurance Commissioner estimates that fifteen companies will become technically insolvent and another forty-one will be financially impaired.]

- If insurance is unavailable from Lloyd's, many California public institutions and businesses will suffer. For example:

  - More than 250 California Hospitals and medical centers will go without essential malpractice coverage.

  - The San Francisco and Los Angeles airports, the Los Angeles Metropolitan Transit Authority and the Bay Area Rapid Transit District will be without Lloyd's coverage. All purchase significant insurance from Lloyd's. Without this insurance, or if the claims payments under their current policies are frozen. as the Department of Corporations intends, these facilities would need to seek other insurance coverage under desperate circumstances and, if alternate coverage is not possible, they might have to close.

- The State of California itself has significant property and liability insurance at Lloyd's. The proposed California Earthquake Authority will lose over $200 million of reinsurance protection. In addition, the City of San Diego, County of Los Angeles, University of California and many other state or municipal entities will be without Lloyd's insurance.

- Hundreds of California corporations rely on Lloyd's for commercial property and liability insurance. Leading companies in aerospace, banking, the film industry and gas and electric utilities, will be without Lloyd's coverage.

Recognizing these disastrous impacts on California, The State Insurance Commissioner is seeking to protect the interests of California policyholders by intervening in the lawsuit in opposition to the Department of Corporations' action.

<u>The litigation potentially endangers Lloyd's future.</u>

Beginning in 1993, Lloyd's returned to financial profitability. Profits for that year, the latest one for which information is available, are estimated to be more than $1 billion. In addition, significant new underwriting capacity has been dedicated to the market. Almost $5 billion of new capacity has been provided during the past three years, mainly by new corporate Names at Lloyd's. The action by the Department of Corporations endangers this recovery and threatens Lloyd's proposed plans to assist Names.

<u>Lloyd's plans to help Names meet their losses.</u>

Lloyd's recognizes that the large losses of the recent years have placed a burden on Names. In May 1995, Lloyd's announced a Reconstruction and Renewal Plan.

One of the most important elements of this plan is the formation of a reinsurer to be called "Equitas." All Lloyd's Names will be able to reinsure their liabilities for the years 1992 and prior with Equitas. By purchasing this reinsurance, Names will be able to resign from Lloyd's, if they so desire. To help individual Names pay for this reinsurance, various participants in the Lloyd's market, as well as Lloyd's itself, is providing more than $4 billion to help offset the cost to individual Names. This money is being contributed from current year profits and contributions from many segments of the market, including the sale of Lloyd's building and Lloyd's historic publishing business. This plan could be undone if the California action succeeds. Ironically, the California Department of Corporations' action could harm many California Names. In its effort to assist Names in avoiding any further payments or recover payments made, the litigation effectively removes all California Names from the $4.5 billion settlement which would be used to reimburse Names' for losses.

For more information, contact:
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(415) 788-7788