Market Bulletin

LLOYD'S

FROM:	Director, Worldwide Markets,	EXTN:	6677
DATE:	7 July 2005	REF:	Y3587
SUBJECT:	**US surplus lines insurance**		
SUBJECT AREA(S):	Direct insurance business from the US written on a surplus lines basis		
ATTACHMENTS:	**Appendix:** US surplus lines insurance		
ACTION POINTS:	**Underwriters to note ongoing compliance requirements**		
DEADLINE(S):	**None**		

Purpose of bulletin

To remind the market of the availability of information from Lloyd's Worldwide Markets about requirements for transacting US insurance.

Worldwide Markets often receives queries from individuals in the market, and those doing business on their behalf, trying to ensure that they comply in full with all applicable requirements. This bulletin is intended to assist the market by pointing out where relevant information can be found.

Lloyd's trading status in the US

Lloyd's underwriters may carry on insurance business from the US in the following ways:

(a) As licensed insurers, in accordance with the terms and conditions of the licences granted to Lloyd's in Illinois, Kentucky and the US Virgin Islands.

(b) As surplus lines insurers, in accordance with local state insurance laws. Lloyd's syndicates may underwrite surplus lines insurance from all US states and territories other than Kentucky and the US Virgin Islands.

A summary of US surplus lines insurance requirements is set out in the appendix to this bulletin.

(c) In accordance with exemptions in US state insurance laws. These exemptions vary from state to state. They exempt from "doing business" laws certain types of risk: for example certain types of marine risk or large commercial buyers, known as "industrial insureds".

(d) In addition a US insured has a constitutional right to leave their state to procure insurance of their own risks, wherever located, with an insurer of their own choosing, a way of placing business known as "independent procurement".

Any "exempt" placement must be handled strictly in accordance with all applicable laws. For example, if an insured travels to another US state where the solicitation, negotiation and effectuation of a placement with an unauthorised insurer occurs, the insured, the broker and the insurer are subject to all applicable laws of that particular US state.

A more detailed summary of exempt insurance is set out in Lloyd's US manual, available via: www.lloyds.com./US. A survey of the exemptions in state insurance laws is available through the same route. When necessary, underwriters should seek their own legal advice before writing insurance on an exempt basis.

(e) As accredited reinsurers. This bulletin does not seek to describe the requirements for handling US reinsurance, a summary of which may be found in Lloyd's US manual, mentioned below.

Information from Worldwide Markets

To assist underwriters and brokers to trade in accordance with local laws and regulations, Lloyd's Worldwide Markets maintains a range of information about requirements across the world on Lloyd's website, www.lloyds.com. This includes information relevant to those handling US direct insurance on a surplus lines basis. Although some of this information is publicly available, other documents are intended for Lloyd's brokers and underwriters only and are therefore accessible only after input of a user name and password. Details of the user name and password are available from Worldwide Market Services, whose contact details can be found at the end of this bulletin.

Information about doing business in the US is available through Lloyd's US web pages, accessible through: www.lloyds.com./US. This page sets out Lloyd's "terms of use": if you accept these terms of use by clicking where indicated, you will go to a page from which you may access documents referred to in the appendix in italics.

A general guide for Lloyd's underwriters and brokers to carrying on US insurance is provided by *Lloyd's US manual.*

This information is not intended to serve as a substitute for regulatory advice tailored to a particular product or situation. Underwriters can seek further guidance from Worldwide Markets via Worldwide Market Services (contact details at the end of this bulletin). When appropriate you should take independent legal advice.

Further information

If you have any queries about this bulletin please contact Lloyd's Worldwide Markets Services:

Lloyd's Worldwide Market Services
Tel: 020 7327 6677
Email: market.services@lloyds.com
Box 190b, Gallery 1

This bulletin has been sent to active underwriters and the compliance officers of managing agents and Lloyd's brokers.

Julian James
Director,
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Appendix

US surplus lines insurance

The documents referred to in italics are available on Lloyd's website, via: www.lloyds.com./US.
Addresses are given for documents available on other parts of Lloyd's website.

Surplus (or excess) lines insurance is coverage that is not available from a licensed (or admitted) insurer and that can therefore be placed with an eligible non-admitted insurer in accordance with state surplus lines laws. US surplus lines insurance is subject to legal requirements laid down by US states. They vary from state to state, and include the following:

Placement by a licensed surplus lines broker: US states require surplus lines insurance to be placed via a surplus lines broker licensed in the state governing placement of the risk.

Underwriters are responsible for ensuring that every US surplus lines risk that they write is placed via a broker who possesses a current US state surplus lines licence in the relevant US state. See market bulletin Y2967 "US surplus lines – surplus lines brokers", dated 9 January 2003 for further details. It can be accessed through this link: www.bulletins.lloydsoflondon.com/Y2967.pdf. In addition, Lloyd's will not normally approve a US intermediary as a coverholder unless it is licensed as a surplus lines broker in the state in which it is located.

Eligibility for export: A risk placed on a surplus lines basis must be eligible for export under the state laws governing the placement. States may prohibit the export of particular lines of business.

A number of states have authority to promulgate an "export list" which sets out those lines of insurance which are automatically exportable without evidence of diligent effort to place the business in the admitted market.

Lloyd's maintains the following *US surplus lines surveys* relevant to export eligibility*:*

- *US states prohibiting health insurance on a surplus lines basis*
- *US surplus lines export list* (providing details of the lines of business that are automatically exportable).

Placement in accordance with surplus lines laws: The exact procedures for exporting business pursuant to U.S. state surplus lines laws vary from state to state. In general a risk can be exported to the surplus lines market only if it is not available in the licensed market, and the surplus lines broker is required to offer a risk (or verify that it has been offered) to licensed insurers authorised to write that type of risk before it can be placed with a non-admitted insurer. Depending upon the law of the relevant state, three to five declinations typically will constitute sufficient proof that coverage is not available in the licensed market. This process is sometimes referred to as "the declination process" or "the diligent search".

The exporting surplus lines broker is responsible for verifying that the declinations are valid and qualify the risk for export for purposes of the diligent search. The procedures and requirements for export are summarized here to assist underwriters in understanding the regulatory system in which U.S. surplus lines brokers operate.

A licensed insurer's quote of a premium higher than the insured wants to pay does not count as a declination, except in unusual circumstances under the laws of a very few states. As a general rule, a surplus lines broker should not export a risk to the surplus lines market solely to get a better rate.

Whether a surplus lines broker may export a risk to the surplus lines market to obtain better/less restrictive terms and conditions of coverage for the insured is a complex issue. If the licensed market's product and the surplus lines market's product are essentially the same product and both would serve the client's needs, the surplus lines broker may not export the risk to the surplus lines market to get better terms and conditions. However, an offer of coverage from a licensed insurer that is so materially different from what the surplus lines market will offer and that is not, in the surplus lines broker's judgment, adequate to meet the insured's coverage needs may be able to constitute a declination for purposes of the diligent search, and export to the surplus lines market generally may be appropriate despite the offer from the licensed insurer.

This determination is necessarily very fact intensive. For example, assume a surplus lines insurer and a licensed insurer are both prepared to offer liability insurance for the owner of an apartment building. The surplus lines insurer is prepared to offer lead paint liability cover but the admitted market is not. Otherwise the products are substantially the same. Is the difference material? If the building was constructed in 1945, the answer may well be yes, but if it was constructed in 2005, the answer is probably no.

Placement with an eligible surplus lines insurer: The surplus lines insurer with whom the business is placed must meet the criteria of "eligibility". The process varies from state to state. The International Insurers Department ("IID") of the National Association of Insurers Commissioners ("NAIC") publishes a "Quarterly Listing of Alien Insurers". This is a list of non-US insurers who appear to meet the criteria set out in the IID's *Plan of Operation for Listing of Alien Nonadmitted Insurers*. In the case of Lloyd's the listing is at syndicate level. The syndicates on the list must meet the IID's requirements, which include:

- Completion and submission of an initial application for listing, with the required listing fee. Worldwide Markets can advise on the listing process for new syndicates: contact Market Services for details.

- Maintenance of a syndicate surplus lines trust fund ("SLTF"), protected by a surplus lines trust deed. The SLTF is funded at the equivalent of 30%[1] of underwriters'' gross actuarially determined US surplus lines liabilities and is adjusted quarterly. In addition Lloyd's maintains a surplus lines joint asset trust fund of $250m plus accumulated interest.

- Quarterly filings to report surplus lines liabilities and assets in the syndicate SLTF's.

- Annual financial filings with the IID.

As well as the IID Listing of Alien Insurers, some states maintain their own lists of eligible surplus lines insurers, although an insurer on the IID list will normally appear on the individual state lists as well. Other states are termed "broker responsibility states", as

[1] The NAIC may require a syndicate to fund at greater than 30%, based on an analysis of its annual NAIC filing.

responsibility rests with the surplus lines broker to satisfy themselves that the non-admitted insurer meets general objective eligibility criteria determined by the state.

Compliance with trust funding requirements means that US surplus lines transactions must be correctly identified and coded. Responsibility for classifying US placements processed through Xchanging correctly rests with managing agents. Lloyd's requirements are set out in Regulatory Bulletin 015/2002 "US regulatory requirements", issued 26 April 2002. It is available through this link: www.bulletins.lloydsoflondon.com/15-2002.pdf

Payment of surplus lines taxes: The surplus lines broker is responsible for collecting and paying surplus lines taxes, normally paid by the insured. There may be circumstances where, in some states, the surplus lines insurer incurs responsibilities for surplus lines taxes that are not paid by the insured.

Filing surplus lines reports with state insurance departments: The surplus lines broker is also responsible for making regular filings with the appropriate state insurance department. These filings provide details of each surplus lines transaction made in that state.

In some states the surplus lines insurer must also file reports of all surplus lines business they have written. In the case of Lloyd's, these filings are made centrally, through Worldwide Markets and Lloyd's New York office.

Other surplus lines compliance obligations: Much of the burden of compliance with US state surplus lines requirements rests with the surplus lines broker. Nevertheless, there are some requirements which affect surplus lines insurers. Worldwide Markets has provided details of some of these by way of Market Bulletins.

New Jersey surplus lines insurance: Special provisions apply to placements of New Jersey. Underwriters must be especially diligent to ensure that every New Jersey surplus lines transaction is handled by a surplus lines broker licensed in New Jersey.

Every New Jersey surplus lines risk submitted to Xchanging must include the New Jersey transaction number. Xchanging have been instructed to decline any risk presented to them that does not include this information.