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**UNAUTHORIZED INSURER OR APPROVED NONADMITTED INSURER: SURPLUS LINES COMPANIES
AND PRE-ANSWER SECURITIES - A COLORADO PERSPECTIVE**

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New technology presents insurers with the opportunity to market products and to provide information to thousands of consumers at once creating national markets where once only regional business was underwritten. Insurers have access to consumers in jurisdictions in which they may not be licensed or have other authority to do business. In lawsuits brought against insurers, consumers face difficulty in obtaining judgements against companies located in other states or foreign countries. The National Association of Insurance Commissioners ("NAIC") becomes increasingly concerned that consumers may not be adequately protected and prepares model statutory language for adoption by the states.

These are not the dilemmas currently faced by regulators, consumers and insurers with the explosion of Internet access and the proliferation of personal computers. The year was 1948 and the NAIC had promulgated the Model Unauthorized Insurers Process Act to address the skyrocketing sale of insurance through relatively new mediums: radio advertising and mass mailings.

In the years to follow, forty-one states (including Colorado) adopted versions of the NAIC Model Unauthorized Insurers Process Act which require unauthorized foreign or alien insurers and reinsurers subject a lawsuit or other legal proceeding to deposit with the court cash, securities or a bond sufficient to secure the payment of any final judgment *before* there is a determination of the merits of the underlying claim or an arbitration.⁽¹⁾ The amount to be posted must be sufficient to pay the full amount of any final judgment. The provisions arm claimant's counsel and ceding insurers with a powerful weapon in negotiating the settlement of claims, using the substantial leverage granted by the statute. Surviving constitutional challenges in numerous jurisdictions, the model act adopted in the various states is found to be narrowly drawn to further substantial government interests even where the insurers or reinsurers simply do not have sufficient assets to meet the required deposit.⁽²⁾

Despite the existence of the unauthorized insurer provisions, insurance regulators and state legislatures recognized an important competing interest in maintaining reliable and affordable insurance markets. In a marketplace where insurance cannot be purchased from an admitted insurer or is so unaffordable as to be deemed unavailable, approved nonadmitted insurers are allowed to issue policies through regulated and licensed surplus lines agents and brokers.⁽³⁾ In the hard liability insurance market of the mid-1980's the only available insurance for many directors, officers and miscellaneous professionals was supplied by these approved nonadmitted insurers. Surplus lines insurance laws dictate "conditions for export" wherein certain surplus lines coverages can be exported to an "approved nonadmitted" surplus lines insurer.⁽⁴⁾ Under the statutory scheme, brokers are the regulated parties in a transaction where nonadmitted foreign or alien insurers serve a valuable function in maintaining a reliable marketplace for hard-to-place risks. Approved nonadmitted surplus lines insurers maintain rate and form freedom and avoid compulsory surcharges and contributions to guaranty funds - in essence the carriers remain outside the jurisdiction of most regulatory control.

However, the theory with regard to approved nonadmitted carriers and the ultimate practice of regulators "approving" these nonadmitted carriers create substantial regulation of this unregulated marketplace. Colorado's Surplus Lines Insurance Act requires that approved nonadmitted insurers "establish satisfactory evidence of good repute and financial integrity" to be placed on "approved list of nonadmitted insurers prepared by the commissioner at least annually".⁽⁵⁾ The so-called "white list" employed by the Colorado Division of Insurance utilizes "standards for approval" which makes those companies which meet

employed by the Colorado Division of Insurance utilizes "standards for approval" which makes those companies which meet the standards for approval arguably the most regulated and reviewed nonadmitted insurers in the nation.⁽⁶⁾ In Colorado, approved nonadmitted insurers must demonstrate two years of "favorable experience" and submit a lengthy list of materials on an annual basis to be eligible to write surplus lines coverages from July 1st through June 30th of each year.⁽⁷⁾ Included in the requirement is evidence that the nonadmitted insurer maintains "for the benefit of all policyholders wherever located" an amount on deposit with a *market value* which equals or exceeds \$2,500,000.⁽⁸⁾ Presumably, this deposit requirement is available to satisfy a judgement against the carrier up to the amount of the deposit.

Once an annual applicant to be an eligible approved nonadmitted submits the required information the Commissioner subjects the applicant to a review of the annual statement of the insurer on a "Colorado basis". Colorado Insurance Regulation 2-4-1 describes this analysis to include:

The application of all provisions of Colorado law **as if the company were a Colorado domestic**. Amounts invested in excess of the maximum investment allowed, or assets which do not qualify under Colorado law, for example, will be deducted from the Company's reported surplus. Similarly, the amount of reserve credit taken for reinsurance ceded to companies **not authorized in Colorado**, and not secured by other **statutorily accepted methods**, or reserve credits otherwise **not acceptable for a Colorado domestic company** will also be deducted from reported surplus. Surplus will be restated on a Colorado basis. The adjusted capital and surplus must equal at least the minimum required by [the Surplus Lines Insurance Act - \$15,000,000 for foreign insurers] (emphasis supplied).⁽⁹⁾

The impact of the Commissioner's "Colorado basis" test is to impose the most restrictive provisions of Colorado's admitted asset laws and the more restrictive provisions of a foreign insurer's domiciliary state's admitted asset law upon an applicant to create a "super admitted asset standard." Further, the "Colorado basis" test eliminates from consideration most applicant companies taking reserve credits for reinsurance ceded with reinsurers not already under the full jurisdiction of the Colorado Division of Insurance and not secured by trust funds or other methods required by *Colorado* law and *Colorado* regulation.⁽¹⁰⁾ Those insurance companies listed annually on Colorado's "white list" probably meet all the standards for becoming admitted carriers and issuance of a Colorado certificate of authority. By virtue of being a surplus lines carrier, they simply retain rate and form freedom. In fact, the \$15,000,000 of *Colorado basis capital and surplus requirements* is 7 and 1/2 times the statutory minimum capital and surplus requirements for an admitted multiple line writer.⁽¹¹⁾ The regulatory scheme used by the Colorado Division of Insurance has operated without noticeable disruption of the marketplace in today's current soft market. It remains to be seen whether the Colorado basis test would allow markets to be maintained in a restrictive hard market.

Despite the rigorous review conducted by Colorado regulators of approved nonadmitted surplus lines carriers which are listed on Colorado's white list and which do maintain a substantial deposit for all policyholders wherever located, the Colorado courts have found these carriers to be "unauthorized insurers" for the purposes of posting pre-answer security and not to be "approved nonadmitted" insurers.⁽¹²⁾ Surplus lines companies that at one time qualified as "approved nonadmitted" carriers for a period of one year and then subsequently elected not to seek listing are subject to the pre-answer security provisions if named in an action along with those carriers currently white-listed. While beyond the scope of this article, reinsurers and Lloyds Syndicates are also subject to unauthorized insurer security provisions despite maintaining separate trust deposits specifically denominated to pay United States based claims.⁽¹³⁾

On April 24, 1997, the Governor of the State of Colorado signed into law Senate Bill 97-109. Section 5 of the legislation amends that portion of Colorado law addressing defensive actions by unauthorized insurers. Specifically, the amendments reaffirm the posting of a pre-answer security unless:

- The insurer makes a showing satisfactory to the court and the Commissioner, that there are, in this state or in another state, cash, securities, bond or other assets sufficient and available to secure the payment of any final judgment which may be rendered in the action, suit or proceeding or that the insurance was placed lawfully in the jurisdiction in which the transaction took place and which was not an unlawful placement under the laws of this state;
- At the time the insurer files any pleading in any action, suit, or proceeding instituted against it, the insurer is listed on the approved nonadmitted insurers list prepared by the Commissioner pursuant to subsection (1) of Section 10-5-108;
- With respect to a contract of reinsurance, the reinsurer has complied with the provisions of this title, necessary to permit the ceding insurer to take credit on its financial statement for the reinsurance pursuant to subsections (5) and

- permit the ceding insurer to take credit on its financial statement for the reinsurance pursuant to subsections (5) and (6) of Section 10-3-118; or
- If an insurer or reinsurer asserts an exemption under paragraphs (a), (b), or (c) of subsection (1) of Section 5, such insurer or reinsurer shall notify the court of the basis on which the exemption is sought and shall file a copy of the assertion with the Commissioner of Insurance.

Summary and Conclusions

The 1997 Colorado legislation addressing exemptions from pre-answer security requirements provides a reasonable guide to the judiciary in recognizing the difference between unauthorized insurers and those insurers and reinsurers for whom imposition of such a requirement was not intended when the model unauthorized insurers process act was first promulgated. Nor is it applicable to the present transaction of the business of insurance. It further provides the judiciary and litigants with the tools for distinguishing the types of entities involved in the litigation and the appropriateness of imposition of the bond requirement. The discretion vested in the court and regulator allows for the recognition of business decisions by an insurance entity which may dictate a decision not to continue to seek regulatory authorization to operate in Colorado. Finally, the law addresses recent unnecessary friction costs associated with litigation on this issue. The Colorado law serves as a reasonable model for clarification of the unauthorized insurers acts of other states.