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COLORADO AND LLOYD'S TRUST FUND REQUIREMENTS

Robert M. Ferm, Esq.
(303) 628-3300

In 1995, Colorado passed legislation pertaining to Lloyd's Situs Trust Fund requirements. Through this act, approximately 20% of the surplus lines market in the state were affected. The controversial legislation stated that a Lloyd's plan must "maintain a trust fund, representing the group's liabilities attributable to business written in the United States."[1] This legislation was modeled after New York Insurance Regulation 41, which was interpreted to require a trust fund with the equivalent of 100% of liabilities issued. New York's experience with requiring 100% gross funding was deemed unworkable over the long term, resulting in a change to the regulation in 1997. The Colorado Division of Insurance also interpreted the legislation as requiring Lloyd's and other similar insurers to maintain a trust fund with the equivalent of 100% of liabilities issued.

In the subsequent attempt to amend Colorado's Lloyd's trust requirements, the requirements of other states were examined. Only three other states required Lloyd's to post all or some part of their surplus lines liabilities in the United States Trust Fund as a condition to eligibility: California, New York, and Louisiana. Colorado, New York, and Louisiana all impose an additional requirement on Lloyd's that the market maintain an additional joint and several U.S. surplus deposit in the minimum amount of $100 million. Other than those states, and perhaps California by cross reference, no U.S. jurisdiction has enacted a statute or promulgated a regulation that requires Lloyd's to post any portion of its surplus lines liabilities in trust as a pre-requisite to eligibility. Instead, other jurisdictions generally require Lloyd's to maintain a fixed dollar deposit in a specified amount, generally $100 million or less depending on local law. In some cases, states have not enacted a provision specifically dealing with the Lloyd's market.

The first state to be examined requiring additional Lloyd's Situs Trust Fund requirements was New York. Prior to December of 1997, New York Regulation 41 had been interpreted to require Lloyd's to post an amount equal to 100% gross surplus lines liabilities. In December of 1997, New York decided to move away from a 100% funding standard for Lloyd's and instead provide for regulatory discretion to set the funding requirement at an "appropriate level" not to exceed 100% or fall below 30% of gross U.S. excess lines liabilities, based on various factors.[2] This was done as part of an agreement with Lloyd's to require Lloyd's to post in trust an amount equal to 50% of U.S. gross surplus lines liabilities.[3]

Another state imposing less drastic requirements on Lloyd's was Louisiana. The Louisiana surplus lines statute was amended in 1997 to introduce a surplus lines liabilities funding requirement for the first time in the state's history. The newly revised statute requires Lloyd's to maintain, in trust, an amount equal to 30% gross surplus lines liabilities.[4] The amount of trust fund required is not to exceed $500 million.[5]

The only other state to impose additional requirements, which happen to be by cross reference, is California. California has enacted a statute that requires Lloyd's to maintain a joint and several trust fund in the fixed amount of $100 million.[6] The statute provides that, if the domicile state of the trust fund requires an amount in excess of that, the California requirement is deemed to be the same as the requirement of the domicile state of the trust.[7] Trusts are physically located in New York City for Lloyd's, thus making New York the domestic regulator. As a result, California essentially adopts the New York standard by cross reference. It is argued, therefore, that a liabilities based requirement is at least implied in the California law through this cross reference. Colorado modeled part of its 1998 legislation after California's "domicile state" cross reference.[8]

Prior to the 1998 legislative session, Colorado had maintained the language requiring 100% liability funding. Consequently, the Colorado statutory language needed to be amended to eliminate the ambiguity and to eliminate the possibility of the loss the Colorado statutory language needed to be amended to eliminate the ambiguity and to eliminate the possibility of the loss of 20% of the surplus lines market. In addition, the language needed to be amended to bring Colorado into consistency with other states also imposing additional requirements on Lloyd's. This could easily be accomplished by clarifying the amount held in a trust fund or multiple trust funds. A statutory change was of great interest to Lloyd's, as well as for Colorado surplus lines brokers who were in a better position to evaluate the potential impact on the loss of this market.

In the 1998 legislative session, the Colorado General Assembly amended the statutory provisions related to Lloyd's Situs Trust Fund requirements in Colorado. House Bill 98-1297 updated Colorado law by adjusting the amount of trust funds Lloyd's and other similar insurers must maintain in order to be eligible to transact the business of insurance in Colorado. The current statute requires a trust fund of not less than $100 million in addition to a trust fund "in an amount satisfactory to the State Insurance Commissioner that is not less than the amount required by the law of the state where the trust fund is located."[9] Colorado had the option of adopting any percentage of funding, but chose instead to give the Commissioner discretion. This language gives the Commissioner the flexibility to adjust the Lloyd's funding requirement to keep Colorado consistent with other states, as well as the NAIC, who was concurrently examining the issue of Lloyd's funding requirements during the Colorado 1998 legislative session.

At the 1997 Winter meeting of the NAIC, the Surplus Lines Task Force and the Special Issues Committee adopted a resolution dealing with a portion of the International Insurance Division (IID) Plan of Operation, which governs Lloyd's United States Situs Trust Fund requirements.[10] This resolution initiated a change in the IID operational plan to allow Lloyd's to reduce its U.S. liability-based trust fund from 100% to 50% of gross U.S. surplus lines liabilities. In consideration for this reduction, Lloyd's would be required to increase its joint asset trust fund from $100 million to $200 million over a three-year period.[11] Lloyd's is further seeking an ultimate reduction of its U.S. liability-based trust to 30% of gross U.S. surplus lines liabilities.[12] The resolution would be effective retroactively on January 1, 1998, and in the interim, the NAIC will be conducting an on-site investigation of Lloyd's and obtaining a legal opinion as to the impact of retroactively allowing Lloyd's to reduce its trust fund liabilities for the years 1995, 1996, and 1997.

It was further clarified at the 1998 Summer NAIC meeting that the aggregate level of the U.S. Situs Trusts should not fall below $600 million.[13] In the event that Lloyd's is unable to obtain the necessary approvals to bring their trust funds into compliance with the NAIC standard form trust agreements, the funding level of the U.S. Situs Trusts will return to 100% of gross U.S. surplus lines liabilities for all years of account after August 1, 1995. Additionally, the NAIC clarified that the $200 million standard for Lloyd's companies was expected to be NAIC policy after the Summer 1998 meeting.[14]

Between the NAIC $200 million standard and the Colorado Insurance Commissioner's discretion, Colorado is now protected from the potentially devastating effect of losing the market to insure Lloyd's type risks. Significant and sufficient financial requirements will be maintained for the protection of Colorado policyholders and further protect the public by placing the final discretion for the amount of trust funds with the Colorado Commissioner of Insurance. The legislation ensures Colorado individuals, businesses, and government agencies access to a significant insurance market essential to providing Coloradans protection for certain unique activities and operations. Finally, House Bill 98-1297 brings Colorado into consistency with other states imposing additional requirements on Lloyd's Situs Trust Fund Requirements.

Endnotes

1. 1995 Colo. Sess. Laws. p.494.

2. New York Ins. Law 2714(g)(2) (McKinney 1998).

3. *Id.*

4. La. Rev. Stat. Ann. 22:1262 and 22:1262.1 (West 1998).

5. Id.

6. Cal. Ins. Code 1765.19(a)(2)(C) and (b)(2) (West 1998).

7. *Id*.

8. Colo. Rev. Stat. 10-5-108(1)(c)(II) (1998).

9. *Id*..

10. Surplus Lines (E) Task Force, National Association of Insurance Commissioners, Winter Meeting Minutes (1997).

11. *Id*.

12. *Id*.

13. Surplus Lines (E) Task Force, National Association of Insurance Commissioners, Summer Meeting Minutes (1998).

14. *Id*.