

FROM: Head of Market Supervision
LOCATION: 86/G5
EXTENSION: 5355
DATE: 26 April 2002
REFERENCE: 015/2002
SUBJECT: **US REGULATORY REQUIREMENTS**
SUBJECT AREA(S): The classification of US placements
ATTACHMENTS: **Appendix 1**
ACTION POINTS: **Immediate**
DEADLINE:

Purpose

To remind Managing Agents of their duties in relation to the classification of US placements, and to restate the US classification procedures required when processing transactions via Xchanging ins-sure Services (“ins-sure” - formerly LPSO) or Xchanging Claims Services (“XCS” - formerly LCO).

Background

Certain market participants have asked that Lloyd’s reiterate the requirements relating to US classifications as there have been a number of instances where the classification of US placements is not clearly reflected on the slip. An illustration is the practice of showing the US classification ‘as endorsed by broker’ or ‘classification – various’ on the underwriting slip.

Enquires received by Lloyd’s centrally have related primarily to large and complex US property and energy accounts; although the guidance in this letter applies equally to any type of business underwritten at Lloyd’s and emanating from the US.

Managing Agents’ Duties

The failure to classify a US risk correctly implies that the Agent could not determine the true nature of the risk and, most importantly, its related US trust fund.

Each risk must be accurately designated and processed on a timely basis via ins-sure, to ensure prompt settlement of premiums, to support the Agent's internal control systems and in order to comply with the regulatory requirements relating to each specific risk. Failure to code risks accurately and promptly calls into question the Agent's ability to comply with the Code for Managing Agents: Managing Underwriting Risk published on 13 March 1997, and may result in a breach of Core Principle No. 9 under the Core Principles Byelaw (No. 34 of 1996).

Failure to classify risks accurately could also have consequences for the management of Lloyd's overseas trading rights and particularly its participation in the US market. Any syndicate accepting US surplus lines or reinsurance risks must have the relevant surplus lines and/or reinsurance trust funds in place. The US classification procedures are necessary to ensure that this is the case.

Consequently, the Monitoring Department will evaluate an Agent's internal controls and ability to comply with the US financial and regulatory regime as part of supervision of the market. Failure to classify risks accurately may result in Lloyd's disciplinary action and US regulatory action against the managing agent concerned.

US Classification Codes Accepted by ins-sure

All US dollar business and all US situs business (regardless of currency) must be given the correct US classification, as detailed in Appendix 1. These must be shown on panel 2 of the slip and on subsequent slip endorsements or any closing bordereaux.

The US Fact Sheets (available from Worldwide Markets) and LMP standard slip guidelines provide further details on placing and closing standard slips.

Complex / Multi-State Risks

In the case of complex risks/multi-state risks, the slip may need to show more than one classification. It is the **responsibility of the underwriter** to ensure that all relevant classifications are shown appropriately, together with an estimate of premium splits. Underwriters must not abdicate responsibility for ensuring appropriate classification to the broker.

If in the initial stages (when underwriters are considering a new risk) this information is not available, then the risk may be shown as *"various – classifications and estimated premium splits to be agreed by lead underwriter, and others, as per terms of slip"*. (On such risks syndicates must subscribe to all US trust funds or note to the contrary.) When the risk is ready to be closed to ins-sure the underwriter/s must have agreed and applied the correct classification/s (as detailed in Appendix 1), **prior to submission for processing by ins-sure**.

Where any doubt remains regarding the classification of certain elements of the risk (e.g. because they may be "non-regulated" or because they may attach later in the risk period) then a US regulated classification (i.e. "surplus lines" or a licensed classification), must be applied in the first instance, including (where appropriate) a breakdown by state.

Underwriters must take into account any notification already provided to the insured concerning US classification (which in certain states is mandatory) – i.e. the insured's

understanding as to whether they have a regulated or non-regulated policy. If the classification is found to have been incorrectly coded in London processing systems only, a change may be made to these systems e.g. from exempt to surplus lines, surplus lines to exempt, etc. **Such changes in classification must be endorsed by the lead underwriter, and others, as per the terms of the slip, prior to processing by ins-sure.** The parties must ensure that following underwriters have the correct trust fund arrangements to cater for the classification that they are agreeing.

Additional Information

US Fact Sheets detailing Lloyd's trading status in the US and procedures for US business are available from Worldwide Markets. If you have any questions relating to this market bulletin, please contact:

In Worldwide Markets –

Sue Blackman, Lloyd's extension 6267 e-mail: susan.m.blackman@lloyds.com

James Walmsley, Lloyd's extension 5131 e-mail: james.s.walmsley@lloyds.com

Questions regarding the classification of individual placements should be directed to Lloyd's Market Services at box 190b or on Lloyd's extension 6677
e-mail: overseas.helpdesk@lloyds.com Fax: 020 7327 5255

Ins-sure - Nick Parker, Tel: 01634 39 2534, e-mail: nicholas.parker@ins-sure.com

This bulletin has been sent to all Active Underwriters, Managing Agents and Lloyd's brokers.

Stephen Manning
Head of Market Supervision

Appendix 1

US Classifications

Licensed

Direct risks written under Lloyd's licenses in Illinois, Kentucky and the US Virgin Islands must be classified as:

- "Illinois licensed"
- "Kentucky licensed", or
- "USVI licensed".

Surplus / Excess Lines

Direct risks written pursuant to the surplus (or excess) lines laws of the state from which the risk is exported must be classified as:

- "US surplus lines"

In addition, the name and address of the licensed US surplus lines broker that has carried out the surplus lines filing must be shown, with the name of the state in which the filing has been made. Care must be taken to show the correct information on slips, endorsements and bordereaux when US brokers file outside their state of domicile and when risks are handled via more than one US intermediary (See US Fact Sheets for further information).

US Reinsurance

For Lloyd's underwriters, the definition of US reinsurance business includes reinsurance ceded to underwriters at Lloyd's by US domiciled insurers or by the US branches of alien insurers that have a port of entry in a state of the US. Such risks can never be classified as "non-regulated" risks. (Reinsurance of a US domiciled captive does not qualify as exempt business. It is regulated business and should be classified and funded as "US reinsurance".)

All risks qualifying as US reinsurance must be classified as:

- "US reinsurance"

If a LOC is issued to the cedent then the risk must still be classified as US reinsurance. Liabilities for this business must be reported by the syndicate as part of its US trust fund reporting. Adjustments should then be made in the syndicate's quarterly US reporting pack, to show the provision of alternative security, thus avoiding double funding.

Lloyd's underwriters are not accredited reinsurers in Kansas nor for accident and health business in New York. Underwriters who write such business must ensure that it is classified as "US reinsurance". Liabilities for this business must be

reported and any LOC issued shown as a deduction in the syndicate's quarterly US reporting pack.

In exceptional cases where the cedent is not seeking to take balance sheet credit, underwriters are still obliged to fund their liabilities as US reinsurance (i.e. in the US Situs Credit for Reinsurance Trust Fund or by alternative security).

Each US reinsured company must be clearly named on the slip and its NAIC company code clearly stated. If the reinsurer does not have an NAIC code the FEIN code may be used instead.

Non Regulated

Non-regulated business comprises:

- *Non-US situs business* - risks that do not qualify as Illinois, Kentucky or USVI licensed, or US surplus lines or US reinsurance, but are expressed in US dollars.
- *Exempt business* - risks exempt from a state's "doing business" and surplus lines laws. These laws vary from state to state.

Risks qualifying as non-regulated must use the classification:

- "Non regulated".

Various

This classification must **only** be used for facility type contracts, such as binding authorities or lineslips, which can produce a mixture of the foregoing classifications. In such instances all underwriters must have subscribed to all US trust funds and have trading rights for the US established, i.e. the term "various" is deemed to include all forms of licensed and regulated classification and syndicates must not subscribe to slips using this classification unless they are eligible to trade in all capacities for the year of account in question. Where used, slips for such contracts must show the classification:

- "Various"

Where facility contracts are dedicated to one or more classifications of US business, then the actual classification as detailed above must be shown.

All bordereaux closings or declarations under facility contracts that have been classified as "various" must show a detailed breakdown of the risks into the appropriate more specific US classifications as detailed above.

Failure to comply with this requirement may give rise to questions over the Agent's ability to manage underwriting risk, and could result in disciplinary action for breach of Core Principle No. 9 under the Core Principles Byelaw (No. 34 of 1996).

“Various” must not be used on any premium or claim closing.

US transactions in currencies other than US dollars

US transactions expressed and settled in currencies other than US\$ must still be classified as US in accordance with this bulletin. The denomination of policies in other currencies does not avoid the need to fund gross liabilities in the appropriate Lloyd’s US Trust Fund. Managing Agents must then make manual adjustments in their syndicate’s quarterly US reporting packs to include the contract’s premiums and liabilities at an appropriate rate of exchange.

Ins-sure and XCS have agreed that the classifications detailed above are the only US classifications that they will accept for processing. Any variations on these classifications (such as the use of ‘as endorsed by broker’ or classification ‘various’ (other than on facility type contracts) will be rejected by Ins-sure.