

FROM: Director, Worldwide Markets EXTN: 6677
DATE: 10 December 2004 REF: Y3453
SUBJECT: **CALIFORNIA INSURANCE: MANDATORY DISCLOSURE STATEMENTS**
SUBJECT AREA(S): Revised disclosure notices and requirements with effect from 1 January 2005
ATTACHMENTS: Appendix 1 California disclosure requirements
Appendix 2 Disclosure Notice D-1
Appendix 3 Disclosure Notice D-2

ACTION POINTS: **Managing agents whose syndicates write California surplus lines and exempt insurance to ensure compliance with requirements. They should inform coverholders and surplus lines brokers handling California business accordingly.**

DEADLINE(S): **1 January 2005**

1. Purpose of Market Bulletin

To inform the market of recent changes to the California mandatory disclosure requirements for nonadmitted insurance.

This bulletin should be read by managing agent staff, underwriters and Lloyd's brokers writing or handling California surplus lines or exempt insurance.

2. Summary of California mandatory disclosure requirements

The California Insurance Code section 1764.1 requires every insurer not admitted to transact insurance in California, and every surplus lines broker, to ensure that the applicant signs a specified disclosure form, when accepting an application for an insurance contract other than a renewal.

In the case of commercial insurance, cover may commence prior to the applicant signing the disclosure notice, if the applicant requires immediate cover for specified reasons and cannot meet the agent or broker in person to sign the disclosure notice. The agent or broker must then obtain the applicant's signature within 5 days of binding coverage, and the applicant may cancel the insurance within 5 days of receiving the disclosure notice.

Lloyd's brought these requirements to the notice of the compliance officers of managing agents by way of a letter sent in April 2002.

3. Changes to these requirements

California has made changes to these requirements with effect from 1 January 2005. As noted above, these requirements apply to “nonadmitted insurance”, which includes insurance written on either a surplus lines or an exempt basis.

3.1. Extension of commercial lines “exemption” to homeowners insurance

California Insurance Code section 1764.1 has been amended to extend the commercial lines “exemption” for disclosure notice forms to residential and personal property insurance. This allows coverage under such policies to commence before the disclosure notice form has been signed, but only if the applicant requires coverage immediately, for specified reasons and is unable to meet with the producer to sign the disclosure notice form.

This provision, in its current form, is set out as “exception 1” in appendix 1.

3.2. New versions of the disclosure notice forms

The California Department of Insurance has also introduced new versions of the disclosure notice forms which must be provided to applicants and policyholders from 1 January 2005. The new disclosure notice forms include paragraphs informing all applicants of this exception and of their right to cancel coverage within five days.

These disclosure notices are available to the Market via the Market Wordings Database – D-1 as LSW1146a and D-2 as LSW1147a.

The LMA will shortly publish updates to their SLC-3 certificates (which incorporate disclosure notice D-2) as LMA3007 (SLC-3 (COR)) and LMA3008 (SLC-3 (OM)).

These requirements remain effective until 1 January 2008 unless amended. Full details of these requirements are set out in appendix 1, together with copies of the disclosure notices in appendices 2 and 3.

4. Responsibilities for compliance

Lloyd’s underwriters can delegate the task of providing a disclosure notice to the California surplus lines broker. Nevertheless, ultimate responsibility for compliance will continue to rest with underwriters. Lloyd’s underwriters must therefore ensure that, from 1 January 2005, all Lloyd’s insurance contracts insuring a person, company or organisation resident or located in California comply with the revised requirements.

Obtaining the signed Disclosure Notice Form D-1 (LSW1146a) from the insured requires action on the part of the broker or agent who is dealing directly with the insured. Managing agents should ensure that surplus lines brokers and coverholders handling California risks on their behalf are aware of the revised requirements and will, in turn, ensure compliance on the part of any broker or agent who is closer than they are to the insured.

Lloyd’s underwriters and brokers must also ensure that the contract document includes Disclosure Notice D-2 (LSW1147a) on its front page. In the case of open market placements (not renewals) where the insured’s address is in California, from 1 January 2005 the slip must refer to LSW1147a under “Conditions” or the updated SLC-3 (OM) California LMA3008. In the case of binding authorities, underwriters should either ensure that

coverholders use the updated SLC-3 (COR) California LMA3007 certificate, or, if any other form of certificate is used, the binding authority should include reference either to LSW1147a or to Disclosure Notice D-2.

The California mandatory disclosure requirements:

- Do not apply to reinsurance.
- Do not apply to renewals.
- Apply to insurances purchased by a “resident” of California any. They do not therefore apply to an insurance purchased by a person or firm resident in another state, which covers property or risks located in California.

5. Further information

If you have any queries about this bulletin please contact Lloyd’s Worldwide Market Services:

Lloyd’s Worldwide Markets 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
Worldwide Markets

Appendix 1

California mandatory disclosure requirements

General Requirements

Under California Insurance Code section 1764.1 every nonadmitted insurer, if insurance is purchased by a resident of California, and every surplus lines broker in the case of a surplus lines placement, is responsible for obtaining the signature of the applicant for any insurance policy (other than a renewal of that policy) issued by a nonadmitted insurer on a disclosure notice form.

The nonadmitted insurer and the surplus lines broker may rely, if it is reasonable to do so, on the disclosure statement received from any licensee involved in the transaction as evidence that the disclosure statement and appropriate signature from the applicant have been obtained.

A surplus lines broker must maintain a copy of the signed disclosure statement for at least five years and must make such records available to the commissioner and the insured upon request.

If the applicant has not received and completed the signed disclosure statement they may cancel the insurance. The premium that the insurer can charge for the period on risk must be calculated on a pro rata basis, and the applicant is entitled to the return of any broker's fees charged for the placement.

The disclosure notice form, D-1, shall be in bold type 16 point type on a freestanding document – see appendix 2.

In addition, every policy issued by a nonadmitted insurer and every certificate evidencing the placement of insurance shall contain, or have affixed to it by the insurer or surplus lines broker, the disclosure statement, D-2. D-2 shall also be in bold type 16 point type and affixed by the insurer or surplus lines broker to the certificate and to the front page of the policy – see appendix 3.

Both notices must be printed in English and in the language principally used by the surplus lines broker and nonadmitted insurer to advertise, solicit, or negotiate the sale and purchase of surplus lines insurance.

Industrial Insured Requirements

When a contract is issued to an "industrial insured", it is not necessary either to provide the applicant with the disclosure notice form D-1, nor to obtain the insured's signature to it. However, it is necessary for the producer to ensure that the D-2 notice is affixed to the confirmation of insurance, certificate, or policy, whichever is first provided to the insured.

An industrial insured is defined as an insured:

- a) Which employs at least 25 employees on average during the prior 12 months; and
- b) Which has aggregate annual premiums or insurance for all risks other than workers' compensation and health coverage totalling no less than \$25,000; or

- c) Which obtains insurance through the services of a full-time employee acting as an insurance manager or a continuously retained insurance consultant. A “continuously retained insurance consultant” does not include
 - i. Any agent or broker through whom the insurance is being placed,
 - ii. Any subagent or sub producer involved in the transaction, or
 - iii. Any agent or broker which is a business organisation employing or contracting with any person mentioned in clauses (i) and (ii).

Note that there are no industrial insured exemptions from the surplus lines laws in California, as there are in some other states.

Exceptions

1. If the insurance transaction is not conducted at an in person, face-to-face meeting the applicant’s signature on the D-1 disclosure form may be transmitted by the applicant to the agent or broker via fax or comparable electronic transmittal.
2. This exception applies to:
 - (a) commercial lines coverage; and
 - (b) personal insurance coverage, and any associated umbrella coverage, covering:
 - (i) loss of or damage to real property which is used predominantly for residential purposes and which consists of not more than four dwelling units.
 - (ii) loss of or damage to personal property in which natural persons resident in property of the kind described in paragraph (i) have an insurable interest, except personal property used in the conduct of a commercial or industrial enterprise.
 - (iii) legal liability of a natural person for loss of, damage to, or injury to, persons or property, but not including policies primarily insuring risks arising from the conduct of a commercial or industrial enterprise.

If the applicant requires that insurance coverage be bound immediately, either because:

- a. existing coverage will lapse within two business days of the time the insurance is bound; or
- b. the applicant is required to have coverage in place within two business days,

and the applicant cannot meet in person with the agent or broker to sign the disclosure form, the agent or broker may obtain the signature of the applicant within 5 days of binding coverage, rather than prior to the coverage commencing.

The applicant may then cancel the insurance within 5 days of receiving the disclosure notice form. The premium charged for the period on cover must be calculated on a pro rata basis and the applicant is entitled to the return of any broker’s fees charged. When a policy is cancelled, the producer must inform the applicant that the broker fee must be returned and that the premium must be pro rated.

These requirements remain in effect until 1 January 2008, unless a subsequent statute deletes or extends that date.

NOTICE

- 1. THE INSURANCE POLICY THAT YOU ARE APPLYING TO PURCHASE IS BEING ISSUED BY AN INSURER THAT IS NOT LICENSED BY THE STATE OF CALIFORNIA. THESE COMPANIES ARE CALLED "NONADMITTED" OR "SURPLUS LINE" INSURERS.**
- 2. THE INSURER IS NOT SUBJECT TO THE FINANCIAL SOLVENCY REGULATION AND ENFORCEMENT WHICH APPLIES TO CALIFORNIA LICENSED INSURERS.**
- 3. THE INSURER DOES NOT PARTICIPATE IN ANY OF THE INSURANCE GUARANTEE FUNDS CREATED BY CALIFORNIA LAW. THEREFORE, THESE FUNDS WILL NOT PAY YOUR CLAIMS OR PROTECT YOUR ASSETS IF THE INSURER BECOMES INSOLVENT AND IS UNABLE TO MAKE PAYMENTS AS PROMISED.**
- 4. CALIFORNIA MAINTAINS A LIST OF ELIGIBLE SURPLUS LINE INSURERS APPROVED BY THE INSURANCE COMMISSIONER. ASK YOUR AGENT OR BROKER IF THE INSURER IS ON THAT LIST.**
- 5. FOR ADDITIONAL INFORMATION ABOUT THE INSURER YOU SHOULD ASK QUESTIONS OF YOUR INSURANCE AGENT, BROKER, OR "SURPLUS LINE" BROKER OR CONTACT THE CALIFORNIA DEPARTMENT OF INSURANCE, AT THE FOLLOWING TOLL-FREE TELEPHONE NUMBER: 1-800-927-4357.**
- 6. IF YOU, AS THE APPLICANT, REQUIRED THAT THE INSURANCE POLICY YOU HAVE PURCHASED BE BOUND IMMEDIATELY, EITHER BECAUSE EXISTING COVERAGE WAS GOING TO LAPSE WITHIN TWO BUSINESS DAYS OR BECAUSE YOU WERE REQUIRED TO HAVE COVERAGE WITHIN TWO BUSINESS DAYS, AND YOU DID NOT RECEIVE THIS DISCLOSURE FORM AND A REQUEST FOR YOUR SIGNATURE UNTIL AFTER COVERAGE BECAME EFFECTIVE, YOU HAVE THE RIGHT TO CANCEL THIS POLICY WITHIN FIVE DAYS OF RECEIVING THIS DISCLOSURE. IF YOU CANCEL COVERAGE, THE PREMIUM WILL BE PRORATED AND ANY BROKER FEE CHARGED FOR THIS INSURANCE WILL BE RETURNED TO YOU.**

Date: _____

Insured: _____

LSW 1146a

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