

"THE UNITED STATES:
THE LAW RELATING TO THE INSURANCE EXCHANGES:
LAX OR OVER DONE?"

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Trying to understand the law relating to the control of insurance and reinsurance in the United States is usually accompanied by a mad search through the equivalent of the law of 50 different countries. Unless the researcher spends that sort of time some very wrong conceptions can occur.

In the case of the Exchanges, however, they are created under special Law adopted in each case by the Legislature of their State of Domicile. Illinois, Florida and New York each have special Chapters dealing with them and when an Exchange makes application for acceptance by another State they do so only on the basis of their being accepted on compliance with the law relating to the writing of either Surplus Line or Reinsurance business.

Each one of the three has trodden that trail and each has now achieved acceptance by a substantial number of other States.

None of the Exchanges is permitted to underwrite on a licenced or 'admitted' basis because they are limited to the surplus line, reinsurance or foreign risks areas only.

Much of the law and also lore relating to their activities is found in addition in the Constitutions which lay down how Members are formed and how they operate. Under these Constitutions yet another layer of control exists in the form of Regulations and in each case changes may only be made after the proposal has been submitted to and approved by the Insurance Department.

The outcome is that although at first sight it could fairly be assumed that the intention was to leave the Exchanges very much alone, practice has shown that just as lively an interest is displayed in them by the Departments as in other domestic insurers. A very good example of this is that in addition to a thorough investigation of each new Member (Underwriting and also Broking) by Exchange Officials and Membership Committees which includes various confidential credit and other reports, the Department then takes the work done by the Exchange and reviews every single aspect taking their time also over doing so.

A common decision taken by the Exchanges in their early days was that they would also insist on Trust Accounts for capital: this is a stronger provision than that exercised for Insurance Companies but was willingly assumed to give reassurance to observers that it would be difficult for anyone of ill intent to behave fraudulently.

The Guarantee each Exchange maintains is also kept in a Trust Fund as opposed to there being just a "Fund" created: the aim was to give as strong an indication of care and control over policyholders' interests as possible.

Probably, however, it is in the approval of Broker Members that the most major addition to State Law has occurred. New York has long had specific laws on Brokers but Illinois and Florida have not except in relation to Surplus Line Brokers. Using Florida as an example, the law confronting Miami's Exchange was that each Broker has to show that he is eligible for Membership because he holds an Agent's Licence: this was clearly not adequate because there are many other things to be concerned about in relation to the performance of a Broker which involve not only the person holding a licence but much more affect the corporation out of which the licenced agent operates.

For example, it is important to know what back-up administratively the Agent has, what E & O Insurance is carried, what the accounting arrangements are and what the financial record of the corporation has been. There being no provisions in the law dealing with this a Regulation was agreed with the Insurance Department which enabled the Exchange to look to the corporation rather than the individual for answers. This created a fiction that whilst the licenced agent alone could become a Broker Member, that person had also to be nominated as their representative by a corporation that had satisfied the Exchange on its standing. The outcome is very similar to the Lloyd's Membership/Substitute system.

An analysis shows that in each case a special status has been created which has been regarded very seriously by Exchange authorities in their regard for the need to convince the outside world that no endeavour will be ignored in maintaining full credibility.

In the case of the new entrants to the American scene - the Underwriting Management Corporations or Bourses - now under way in Texas under the Texas Lloyd's legislation - equal determination exists to ensure that there is full compliance with the law controlling them.

The Texas Lloyd's are not Exchanges: they are specially approved organisations made up of individuals, partnerships or associations of individuals who may then appoint Underwriting Managers who report to an Attorney in Fact who as in the case of Lloyd's in Illinois is responsible to the Insurance Commissioner. There are important safeguards imposed in the protection of policyholders which permit only certain forms of investment and which call for full reporting but one very significant difference exists between the Texas Lloyd's and the Exchanges which is that in Texas they may write on an admitted basis as opposed to surplus line. Minimum capital requirements are also lower: the Texas Lloyd's decision in the case of

Lloyd's U.S. has been to require a minimum of \$400,000. Otherwise, controls are much the same.

Over all therefore it can be said that because of the mingling of self and Departmental controls and because Exchange and Texas Lloyd's controls are more able to be strengthened with speed because no legislation is required they are much regulated but the combination of industry and bureaucrat works well.

Two very important legislative changes have nevertheless occurred recently in New York and Florida. In the case of the former the minimum capital requirement has been put up to \$5 million and in the latter case a new type of Membership has been brought into law which should swell the numbers of Syndicates substantially once it is understood.

Small corporations may now be formed capitalised at a minimum of \$100,000 each which may then combine with a minimum of 19 others to create reinsurance pools which may collectively then enter into Membership as "Syndicates". This brings membership within the grasp of many more people because the incentive will be the tax advantages such corporations offer which are far better than the old Sub Chapter S concept or the limited partnerships New York sought to have approved in the early days.

This is a very interesting move which should stand Miami in very good stead for the future and illustrates the seriousness with which the Legislature regards its baby which now has over the 20 Syndicates and \$50 million in premium forecast for it.

THE 1985 CHAIRMAN'S LUNCH

The 1985 Chairman's Lunch was held on Wednesday, 6th June, at the Elizabethan Suite, Barrington House, Gresham Street, London and BILA was very fortunate that our Chairman, Alan Dolden, had