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134

Offered: 4/18/83
Referred: Rules

Original sponsor: Mulcahy

BY THE LABOR AND
COMMERCE COMMITTEE

1 IN THE SENATE

2

CS FOR SENATE BILL NO. 134 (L&C)

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

THIRTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to surety bond and financial re-
7 quirements for insurers of surplus lines."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. A 21.33.160 is amended to read:

10 Sec. 21.33.160. FILING SURETY BOND AS A CONDITION TO LICENSE.
11 Before receiving a license the applicant shall file with the depart-
12 ment a surety bond in favor of the state and insureds in the penal sum
13 of \$50,000 [\$25,000]. The bond shall be issued by an authorized
14 corporate surety approved by the department. The bond shall be condi-
15 tioned on the conduct of business under the license in conformity with
16 the provisions of this title, including the payment of all taxes
17 required to be paid by this title. The applicant shall keep the bond
18 in effect during the period of the license. The surety may terminate
19 the bond by giving at least 30 days written notice to the department.

20 * Sec. 2. AS 21.33.180(a) is amended to read:

21 (a) A surplus line broker shall ascertain the financial condi-
22 tion of an insurer before placing insurance with the insurer [HIM]. A
23 broker may not place or renew surplus line insurance with an insurer
24 which the broker [HE] knows or should with due diligence, determine to
25 be financially unsound, nor may the broker place surplus line
26 insurance with an insurer which has capital and surplus of less than
27 \$1,500,000 [\$600,000] unless there is on file with the department a
28 copy of a trust agreement, certified by the trustee, evidencing an
29 existing trust of at least \$1,500,000 [\$450,000] which is deposited by

25,000

1 the insurer in a United States bank or a United States trust company
2 and held for the protection of the insurer's United States
3 policyholders. The department may waive the financial requirements in
4 this subsection in circumstances in which insurance on risks located
5 in this state cannot be procured under the requirements.



Alaska State Legislature

Senate

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

SB 134

Sectional Analysis:

- Section 1) Increases the surety bond requirements for a surplus lines broker from \$25,000 to \$50,000. This proposed increase would have the effect of placing the surplus lines broker under more thorough scrutiny by the surety posting the bond. The bond can be accessed by the state for recovery of unpaid taxes by the broker, and the addition of the words and insureds would allow the consumer to recover at least partial re-compense for losses resulting from a policy placed with an insolvent company.
- Section 2) Increases the capital and surplus requirements for surplus lines insurance from \$600,000 to \$1,500,000. In the alternative to that capital and surplus requirement, a trust agreement of \$1,500,000 [currently \$450,000] would be sufficient.



Alaska National INSURANCE COMPANY

A policy of service and protection

LEGISLATIVE POSITION PAPER:

LEGISLATION:

Senate Bill No. 134

PURPOSE:

An act relating to surety bond and financial requirements for insurers of surplus lines.

SUBSTANCE:

This measure would increase the bonding requirements for surplus line brokers and would increase the surplus requirements for surplus line insurers permitted for use in this State by surplus line brokers.

POSITION:

Not opposed.

ACTION:

No action is necessary, however, if asked you might suggest certain improvement amendments.

BACKGROUND:

In order to do business in the State of Alaska, an insurer must be authorized by the Division of Insurance to transact insurance in this State. As a condition of issuing the Certificate of Authority to an insurer, the Division requires that the insurer comply with the rating and form requirements imposed upon all insurers. Often times risks require coverages which a carrier cannot provide within the framework of approved rates and forms; and, thus, goes outside the State of Alaska to procure the insurance from carriers which are not authorized to write business in this State. Surplus line brokers are those brokers who are specially licensed to procure insurance outside the State of Alaska from carriers not authorized to write in this State for risks in this State that cannot otherwise acquire those coverages. Examples would be aviation liability or hull insurance, insurance on special properties located in remote areas and other hard to place risks.

This business is referred to as surplus lines or excess insurance.

Though the Division of Insurance has no jurisdiction over these unauthorized insurers, it does have jurisdiction over the surplus-line brokers which procure the insurance and it attempts to protect the buying public by limiting the actions of the surplus line broker. This is, since the insurers are not regulated, only brokers with special experience are permitted to access these otherwise unauthorized insurers. It is appropriate that the bond be increased and it is appropriate that the surplus requirements for those unauthorized insurers which the surplus line brokers uses, be increased.

One of the difficulties with the existing law is that it does not require the surplus line broker to maintain any kind of surveillance over the financial condition of the unauthorized insurers; and only requires that at the time the insurance is placed, the broker have no knowledge of the insurers financial unsoundness.

I would argue that the broker has an ongoing responsibility to review the financial condition of the unauthorized insurers which it uses, and I would suggest that the language be modified to read as follows:

21.33.180 (a) "A surplus line broker shall ascertain the financial condition of an insurer before placing insurance with the insurer. A broker may not place or continue surplus line insurance with an insurer which the broker knows or should with due diligence, determine to be financially unsound, ... [Emphasis on language recommended to be added-other language as per amendment proposed by SB 134]".

SB 134, Line 21 to 24.

DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

POSITION PAPER

SB 134: An act relating to surety bond and financial requirements for insurers of surplus lines.

The Administration favors the passage of SB 134. This bill is admittedly a "band-aid" approach to resolving the shortcomings of the surplus lines law in the insurance code. It does allow time to effect a more thorough review of the surplus lines law by correcting some of the more glaring deficiencies in the law.

The bond requirements for a surplus lines broker was last revised in 1970. The purpose of such a bond is to prequalify the license holder. If the bond is of sufficient size, this is accomplished as the surety providing bond does a more thorough job of checking the person to be bonded. If the bond is not large enough, the surety may tend to be lax in its efforts. The bond should also be sufficient to provide some protection for the State and the public. Recent occurrences suggest that a \$25,000 bond may no longer be adequate. A \$50,000 bond is a reasonable step up until the issue is considered as part of a broader action.

The current minimum for an admitted multiple line property and casualty insurance company is \$1,500,000. The surplus lines law which is unchanged in this regard since 1970 requires only \$600,000. This is woefully inadequate, particularly since that market is basically not subject to State regulation except, perhaps, in its domiciliary state. An increase to a level that is required of an admitted company or one newly forming in this State is a reasonable step.

This is a good bill and we would urge its passage.



4/13/83

Richard A. Lyon, Commissioner

Don Mack

STATE OF ALASKA
PRELIMINARY STATEMENT OF FISCAL IMPACT

Bill No: SB 134 Date on Bill: 2/22/83
 Title: An Act relating to surety bond and financial requirements for insurers
 Sponsor: Mulcahy of surplus lines.
 Requestor: _____

1. Estimated fiscal impacts on:

a. Expenditures:

(Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86
Capital		0	0	0
Operating		0	0	0
Total		0	0	0

b. Revenues:

Revenue		0	0	0
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2. Source of funds to offset fiscal impact of bill:

3. Assumptions:

4. Disclaimer:

This statement has not been reviewed by the OMB in the Office of the Governor. It therefore does not represent the final estimate of fiscal impact.

Prepared By: Kenneth C. Moore, Director
 Division: Insurance

Phone: 465-2515

Date: 3/9/83

Approved by Commissioner: Richard A. Lyon
 Department: Commerce and Economic Development

Date: 3/9/83

5. Distribution:

Original to Legislative Finance

Copy to OMB

Copy to Sponsor

Copy to Requestor

Fiscal Note

2/15/83

INSIDE INSURANCE

Big losses raise question of 'moral hazards'

'Most people are not in a position to make money off of sinking their vessel'

by Robert Mann

Millions of dollars worth of fishing vessel losses in 1982 have broken over Seattle's marine insurance community like a rogue wave at sea. The result, according to brokers and underwriters, could be that fishermen will be paying higher deductibles and premiums in the very near future.

Although the Coast Guard does not keep track of the total number of fishing vessels and processors lost in a given year, some worried underwriters are drawing up lists of their own. The 1982 numbers look pretty grim to companies that are insuring Alaskan fishing vessels.

According to one list, there have been over \$48 million worth of total losses of crabbers, seiners, draggers, processors and gillnetters through November of 1982. Five processors, three of which burned and sank within a six week period,

accounted for \$29 million worth of the total; the *Al-Ind-Esk-A-Sea*, which burned and sank off Everett on October 22, was perhaps the most spectacular of the losses. Another underwriter said over \$22 million worth of crabbers sunk, burned, or ran aground this year.

Bad times seem to bring an increase in the number of reports of vessel owners burning or deliberately sinking their boats to collect the insurance money so they can get out of the business. The fact is, though, that not much is usually gained from that kind of act, according to several underwriters.

"When people are going broke, it seems that the friction of the mortgage against one's wallet seems to heat up the back of the boat, and away she goes," quipped John Adams. Adams manages Pacific General Agency, Inc., a company that insures millions of dollars worth of fishing vessels throughout the U.S.

Adds Adams: "It really does a fisherman no good to file a claim or

have a convenient loss, if he is going to lose his ability to make a living. Most people are not in a position to make money off of sinking their vessel. At best, they usually get the mortgage paid off."

Maurice Oaksmith, an insurance broker, agrees with Adams for different reasons. "I really don't think that 'moral hazards' (intentional sinkings and burnings) are a factor right now, even with the depressed state of some of the fisheries. I've got great faith in human nature, particularly in the fishing industry."

Others in the insurance business, however, do not share Oaksmith's "faith" in human nature in the fishing fleets. One president of an insurance company here instructed his underwriters not to carry any more lines on converted processors, which he labeled, "floating fire hazards." Another marine insurance underwriting firm, Mathews & Livingston, Inc., bailed out of the fish vessel business in 1981 because "it is a volatile market and we were

looking at doubling our rates from our London connection," says a company spokesperson.

"My friends at Lloyd's say the Northwest and Alaska losses have just about destroyed their marine underwriting syndicate," says a former British underwriter who has worked in the U.S. marine insurance industry for two years.

Lloyd's and other western European companies that assume part of the risk on American fishing vessels are quoting prices that many U.S. brokers and underwriters are finding hard to sell to customers. An understanding of why the European insurers are shying away from the fishing vessel business requires a brief explanation of how marine insurance works.

Imagine a pyramid with the broker or underwriter sitting at the top. The fisherman comes into the office, and tells the broker or underwriter what kind of policies he wants and what he is willing to pay. (Most fishermen are covered for losses or damage to the hull and

machinery. A fisherman, no matter what his past record, can usually find someone to insure him.) The broker then goes to his underwriters—the first set of risk-takers, who usually carry only a small percentage of risk themselves. The risk on expensive fishing vessels is always spread out among re-insurers.

The most reliable re-insurers are in London at Lloyd's or the Institute of London Underwriters and other western European countries. Those companies, though, may spread the risk even further down the pyramid. At the bottom of the pyramid, you might find that a company you never heard of in Latin America might be assuming a fraction of a percentage of the total risk on an Alaskan fishing vessel. When claims are made, payment starts at the pyramid's bottom and works its way up.

According to Adams and others, North Pacific fishing vessels have a bad reputation in the European re-insurance market, hence the doubling and tripling of rates in the last two or three months. As a result of the increases, some smaller companies have been forced to seek reinsurance with unproven foreign security firms.

"The London and Western European reinsurance markets have just dried up," says Adams. "It's imprudent for a company like ours to hold all the risk on a crabber with a high degree of hazard. We have to have re-insurers and as these re-insurers drop out, there goes the market."

In the competitive marine insurance business, some companies are so hungry for premium dollars they are re-insuring through companies in South Africa, the Bahamas, and Hong Kong. "You have to realize that there are over 600 companies based in Hong Kong alone, and most of them are only a name in the phone book," said Adams, who adds that many claims go unpaid. "Many of the foreign securities firms will disappear before the claims can get in."

Says Maurice Oaksmith, "Insurance companies and syndicates make money from underwriting and investment income. Now that interest rates are lower on short-term money, the competition for insurance premium dollars is getting even heavier. Some people want to make a quick killing by buying their reinsurance as cheaply as possible so that they can keep most of the premium. They tend to stray into left field re-insurers."

Oaksmith says that "If underwriters are selective, and properly re-insured, they can make money writing fish boats at or near the level of where premiums are today."

John Adams knocks on his desk and says his firm has made money. "We have tried to be cautious with those people that we suspect." But Adams feels that most marine insurance underwriters and brokers today do not know their market. "In the past few years we've seen the inundation of the marine insurance market with inexperienced people with all kinds of capacity. There have been more and more companies coming in and diving right out again after a few hard licks."

damn good salesmen who are very gullible because they don't want to know the truth about the security they're representing. If it's an undesirable risk, it will usually end up with what we consider to be the less inquisitive underwriters who fail to ask the questions they should ask."

Adams maintains that there are very few underwriters who truly understand the fishing business well enough to know when to ask if a person is a "known troublemaker with a poor record in the past. Some people, though, are not crooked, they're just doggone unlucky," says Adams.

Adams feels most underwriters insuring fish boats should know how machinery operates so that they can know if a claim is legitimate or not. "Most underwriters don't know anything about claims. Unfortunately, the claims people think the underwriters know everything," says Adams.

Although Adams has worked around fishing boats a long time, he says he is often too busy to get the chance to visit the docks to inspect fishing vessels he insures, although he says he tries to as often as possible. Like others, he relies on marine surveyors, the eyes and ears of every underwriter or broker. (See accompanying story.)

Marine surveyors perform condition and valuation (C&V) surveys for vessel owners, insurance companies, and banks. They check a vessel's wiring, construction, deck equipment, rigging, navigation equipment, electronics, cabin arrangements, safety and life saving equipment, hydraulics, engine room, and even the vessel's housekeeping and appearance. They also note any recommendations for improving the vessel before reaching what they feel is a fair market value for the boat.

"Surveyors have a pretty good feeling for what a boat's value is, and they understand replacement costs," says Oaksmith. "But there can be honest differences of opinion between a surveyor and a boat owner."

Some surveyors say they are pressured to keep boat values high even though their market values might be depressed in a weak market. According to one surveyor who ran a C & V survey on a large

floating processor in 1979, the vessel's owners pressured him to keep the value high because the bank had loaned them a lot of money on processing equipment. The surveyor says he told the owners that the boat had no track record and needed more work, so he valued it substantially less than what the owners had wanted.

"I gave them two legal-sized sheets of repair and safety recommendations, and two months later they had somebody else doing the survey. They obviously wanted someone who would agree with their value," the surveyor says. He asked to remain anonymous. "I have quit one job before because the guy hasn't done what I've asked him to do. But within a week he's got insurance from somebody else."

"What's happening in the present market is that a lot of people are not insuring market values. They're insuring investment value," says another veteran surveyor. "A lot of money had to be put into that processor to get her operable, and



Maurice Oaksmith

BOAT INSURANCE

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the company wanted to insure that investment."

However, other surveyors say they are rarely pressured into inflating vessel values. John Adams, for instance, says "Sometimes the vessel owner wants surveyors to debate the value because he doesn't want to pay the money on high insurance premiums on boats that are fully paid for."

"Most surveyors know what they're doing," says one claims investigator, "but some have great gaps in their experience and training. Some surveyors specialize in cargo only, others in tug boats, others in yachts, and some in crab boats. Frequently their expertise is limited to their specialty class of vessels, and they're not able to adapt well to new classes."

Adams adds, "The jam is that many people will accept a surveyor's

report on a matter for which he is not truly qualified."

Surveyors have already formed their own national association fifteen years ago in an effort to police their own trade. In order to join the National Association of Marine Surveyors an applicant must have at least five years full-time surveying experience and he must pass an exam on his specialty class of vessel. "It's still in its infancy," says one member.

Whether an underwriter or vessel owner decides to hire, fire or believe a surveyor does not diminish the importance of their C & V surveys. When claims are paid, they are the most important records available, because foul play is almost impossible to prove. Underwriters rarely go to the bother and expense of trying to prove arson or intentional sinking; they simply pay the claims based on a vessel's surveyed value. Raising the vessel and re-surveying it is the only way to change the surveyed value.

Adams jogs his memory back to 1958 when a wooden seiner sank in the Puget Sound and the underwriters raised the vessel. "There were funny ax holes in the bottom of the boat that were made from the inside. These rapid termite jobs are good for some people, but when an owner gets caught with evidence like that, it is a federal crime and the punishment can be severe. From an underwriter's standpoint, you have to look at how much a mortgage is on a vessel before thinking about deliberate sinkings.

"It's easy to say that when the mortgage is high and the values are dropping beneath the mortgage, it

becomes advantageous to have an accident. But that's only part of the story," says Adams.

"The other part is that people are working harder and pushing their crews harder and harder trying to make a profit. Everybody gets tired."

Maurice Oaksmith, who grew up on Alaskan fishing boats, says, "I think fishing vessels in many ways are a better risk today than they were four years ago. There are many more alarms, detection devices, and better navigational equipment. But one thing you've got to guard against, as technology advances, is complacency."

Adams blames accidents involving some crabbers on "electronic creature comforts" along with drug use by younger crew members who doze during their wheel watch.

In some cases, though, he says accidents are not due to overwork, drugs, or high-tech instruments. "In Bristol Bay we never have a total loss prior to the season unless it's truly accidental. It always seems to happen just before the end of the season, and "Oh, my god, the fire started," or "I hit a rock." There aren't very many rocks in Bristol Bay, so they either swamp or burn.

"It always happens where it's hard to recover the boat, in the dark of night; a friend just happened to be coming along and he saw the fire, and 'I got off without getting my tennie runners wet.'"

Adams admits that he is speaking somewhat facetiously; he knows that Bristol Bay permits can cost up to \$100,000. Yet he sincerely feels that "moral hazards"—"sinking the damn boat"—are higher these days,



John Adams

and the way to prevent them is to make sure the owner starts accepting some of the risk.

He looks back to the 1930's during the Great Depression when there were a lot of similar vessel losses occurring. According to Adams, an underwriter would co-insure the vessel, assuming only part of the risk in case of partial losses; the owner would pick up the rest. The other alternative he sees is charging very high deductibles.

Adams thinks strict Coast Guard enforcement of safety regulations helps reduce risk, too. Under Section 46, Parts 24 through 26 of the Code of Federal Regulations, the Coast Guard can board uninspected fishing vessels and check for safety and fire fighting equipment violations. But Coast Guard spokespeople say they do not have the manpower to check fishing vessels unless they receive a specific

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TRAC 4

BOAT INSURANCE

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complaint.

Maurice Oaksmith, one of the founders of the National Council of Fishing Vessel Safety and Insurance, says the "industry ought to consider self-regulation. The principal reason for forming this national group was that insurance costs were high, and the only way to bring them down was to decrease the severity and frequency of accidents. I would say that about 90% of all accidents and fatalities are avoidable. Usually they result from somebody doing something they shouldn't do."

There is a general consensus among marine surveyors, underwriters, and claims investigators

that human error, due to lack of adequate training, is responsible for many legitimate accidents. In the case of converted floating processors, however, there are other dangers.

During the conversion process, bulkheads and cofferdams are usually removed to make more room for processing equipment, forklifts, and elevators. "They cut out watertight bulkheads so it's easier to move cargo down to the freezing holds and along the processing leek," explains surveyor Jim Goldade.

"In the case of one processor," says another surveyor, "all three holds had been cut through all the way back to the engine room. You can pump such a vessel full of water,

but you've got no way to pump it out again. There are no subdivisions to control flooding or fire in these vessels."

Highly flammable polyurethane foam is also an acknowledged fire hazard aboard such processors.

"We've glossed over these problems in the last few years because of a very competitive insurance market, due to excess capacity and underwriters seeking premiums at any cost," says one concerned claims investigator. "Now that interest rates are declining and losses are continuing to accelerate, the conditions are set for a scarcity of insurance and possibly a recognition that standards will be necessary if losses are to be controlled." □