SECURITY DEVICES FOR UNLICENSED REINSURERS

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1. INTRODUCTION

Reinsurance is the process by which an insurance company cedes a portion of its risk to another insurer called a reinsurer. A ceding insurer purchases reinsurance to increase its capacity to take on underwriting risk and to reduce adverse or volatile financial results, such as those caused by natural disasters or other unexpected losses.

A variety of reinsurers assume risk from ceding companies. Many are U.S.-domiciled professional reinsurers. Others are the reinsurance departments of primary insurers. These companies are licensed in some or all states and are regulated for solvency by insurance commissioners in essentially the same fashion as other domestic licensed insurers.

A substantial portion of U.S. insurance risk, however, is assumed by unlicensed foreign reinsurers that do not maintain offices in the United States and that are not regulated for solvency in any state. In 1992, over 42% of the reinsurance ceded by U.S. insurers went to such reinsurers. This

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2 In the reinsurance context, the term cede refers to the laying off of a portion of the risk.

represented $8.4 billion in premiums to unaffiliated foreign reinsurers and $28.6 billion in reinsurance recoverables. Since these foreign reinsurers are not subject to domestic solvency regulations, ceding insurers are prohibited from treating reinsurance from unlicensed reinsurers as an asset or a deduction from liability unless the obligations are adequately collateralized.

Collateralization devices are extremely important to U.S. creditors. If unlicensed insurers default on their obligations, the creditor can, theoretically, collect what it is owed from such devices and avoid pursuing assets in a foreign jurisdiction and subjecting itself to the vagaries of a foreign bankruptcy court. The purpose of this Article is to examine the efficacy of collateralization devices for reinsurers that are not domiciled or licensed in the United States.

2. REINSURANCE COLLATERALIZATION DEVICES

2.1. Current Law

Credit for reinsurance laws have become much more uniform in recent years, largely because the NAIC Model Law on Credit for Reinsurance ("Model Act") has been included in the NAIC state accreditation program. Given this similarity, this Article will focus its analysis on the Model Act.

The Model Act and its recommended regulation ("Model Regulation") separate reinsurers into two basic categories: those that are treated as licensed reinsurers and those that are treated as unlicensed. The general philosophy of the Model Act is that credit for reinsurance from licensed reinsurers should be granted without collateral being posted

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4 Id. at 12.
5 Forty-five states have the NAIC Model or similar legislation, with a bill for such pending in Michigan. 1994 MODEL REGULATION SERVICE (NAIC) 785-7 to 785-10.
6 Model Law on Credit For Reinsurance (1994) [hereinafter Model Act].
8 Credit for Reinsurance Model Regulation (1991) [hereinafter Model Regulation].
9 See Model Act, infra note 6, § 1.
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by the reinsurer since the reinsurer is already regulated for solvency in the United States. The solvency of unlicensed foreign reinsurers cannot be determined, however, because those entities are not subject to the scrutiny of state regulators. A ceding insurer, therefore, will require collateral from an unlicensed reinsurer that underwrites a risk. The collateralization requirement reduces the primary insured's risk vis-à-vis the reinsurer.

The issue is complicated, however, by the fact that the Model Act treats some reinsurers as "licensed" even though they are not licensed in any state. Section 1 of the Model Act delineates the qualifications for determining whether a reinsurer is treated as "licensed." \(^{10}\) Section One includes: (1) a reinsurer licensed in the state of domicile of the ceding insurer; (2) a reinsurer that is licensed in at least one state and becomes accredited (an abbreviated licensing process) in the state of domicile of the ceding insurer; (3) a reinsurer that is licensed in a state with a credit for reinsurance law which is substantially similar to the law of the state of domicile of the ceding company; and (4) a reinsurer that posts collateral in a single trust fund for the benefit of all U.S. policyholders and ceding insurers (a multiple-creditor collateralization device). \(^{11}\) A ceding company may represent reinsurance recoverable from any of these "licensed" companies as an asset on its financial statement. \(^{12}\)

Section 2 of the Model Act describes another collateralization device for those unlicensed reinsurers who cannot, or choose not to, qualify as licensed under Section 1. These reinsurers are required to post a trust or a standby letter of credit for the benefit of each ceding company (a single-creditor collateralization device). \(^{13}\) Section 2 allows a ceding company to reduce its liabilities, as reported in its financial statement, by the amount posted in the reinsurer's letter of credit or trust obligation. \(^{14}\) The nature and efficacy of both single and multiple creditor collateralization devices will be explored below.

\(^{10}\) Id. § 1(A).
\(^{11}\) Id. § 1(A) to (D).
\(^{12}\) Id. § 1.
\(^{13}\) Id. § 2.
\(^{14}\) Id.
2.2. **Multiple-Creditor Collateral Devices**

In Section 1(D) of the Model Act, three types of entities are allowed to post a single pooled trust fund for the benefit of all U.S. policyholders and ceding insurers. These entities consist of an individual reinsurance company, a group of underwriters consisting of both incorporated and unincorporated underwriters (e.g., Lloyd’s of London) and a group of incorporated underwriters (e.g., the Institute of London Underwriters) with an aggregate policyholders’ surplus of $10,000,000.\(^\text{15}\) This Section also requires that each entity annually provide regulators with substantially the same information required of licensed insurers. This disclosure on the part of unlicensed insurers, with regard to the sufficiency of the required trusts, serves the same function as the solvency test required of domestic insurance companies.\(^\text{16}\) The trust must be maintained in a “qualified financial institution,” defined in the Model Act to include financial institutions organized or licensed in the United States or any state thereof granted authority to operate with fiduciary power and regulated by federal or state authorities that have province over banks and trust companies.\(^\text{17}\)

A single reinsurance company is required to hold in trust a surplus of $20,000,000 in excess of the reinsurer’s actual liabilities to policyholders and ceding companies.\(^\text{18}\) The $20,000,000 figure serves as a solvency margin or surplus, such as would be required of a licensed reinsurer. It also protects against under reserving by the ceding company. A group consisting of both incorporated and unincorporated underwriters must maintain a similar surplus of $100,000,000; this amount is over and above the insurers’ several liabilities to U.S. policyholders and ceding companies and is held jointly for the benefit of ceding insurers.\(^\text{19}\) The same size fund must be maintained by a group of incorporated underwriters.\(^\text{20}\)

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\(^\text{15}\) Id. § 1(D); Model Regulation, supra note 8, § 7.
\(^\text{16}\) Model Act, supra note 6, § 1(D).
\(^\text{17}\) Id. § 3(B).
\(^\text{18}\) Id. § 1 (D)(1).
\(^\text{19}\) Id.
\(^\text{20}\) Id. § 1(D)(2).
The form of the trust fund is subject to the approval of each insurance commissioner. In addition, the trust must contain a number of provisions: (1) claims may be paid out of the trust thirty days after entry of a final order of a court of competent jurisdiction in the United States; (2) legal title to the assets in the trust shall be vested in the trustee for the benefit of U.S. policyholders and ceding insurers; (3) the trust shall be subject to examination by each insurance commissioner; (4) the trust shall remain in effect for as long as the reinsurer or any member of a group thereof shall have outstanding obligations under reinsurance agreements subject to the trust; (5) no later than February 28th of each year, the trustee shall report to each commissioner the balance in the trust and certify that the trust will not expire prior to the following December 31st; and (6) no amendment to the trust shall be effective unless approved in advance by each commissioner.

Relatively few reinsurers have utilized this multiple-creditor collateralization device. The most prominent are members of Lloyd's, who use a pre-existing premium trust in the United States for this purpose. The Institute of London Underwriters has considered creating such a trust, but has not actually established one.

2.3. Single-Creditor Collateralization Devices

Much more common are trust funds and standby letters of credit designed to collateralize obligations to individual creditors. Funds must be placed in these trusts by year end and the ceding company is allowed to reduce its balance sheet liabilities by an amount equal to the collateralization. Stated differently, if the collateralization is less than the recoverable from the reinsurer, the ceding company may not reduce its liabilities by the amount of the deficiency.

The single creditor collateralization devices are much more

21 Id. § (D)(3).
22 Model Regulation, supra note 8, § 6 (c).
23 Lloyd's trust fund, established over fifty years ago, is estimated at $9.6 billion. Meg Fletcher, U.S. Regulators Step Up Oversight of Lloyd's, Bus. Ins., Aug. 29, 1994, at 42.
24 Unfinished Business, supra note 7, at 76.
25 Model Act, supra note 6, § 2.
structured than the multiple creditor devices. The trust is for the express and sole benefit of the ceding insurer, which may withdraw assets at any time, without notice to or approval of the reinsurer. The reinsurer may withdraw assets from the trust only with the beneficiary's approval. The reinsurer may, however, substitute assets upon call or maturity and may withdraw amounts that exceed 102% of the reinsurer's obligations to the beneficiary. The trust assets must consist of: (1) cash; (2) securities listed by the Securities Valuation Office of the NAIC and qualifying as admitted assets; (3) a clean, irrevocable, unconditional and "evergreen" letter of credit issued or confirmed by a qualified financial institution; or (4) any other form of security acceptable to the insurance commissioner.

The Model Act and Regulation describe in great detail the requirements that govern the form of the trust or letter of credit. Additionally, the Model Act and Regulation delineate the permissible uses of funds by the beneficiary as well as the acceptable terms of the reinsurance contract clauses utilized in conjunction with the single creditor collateralization device. These requirements differ significantly from the requirements for multiple-creditor collateralization devices, and the principal differences are noted above.

2.4 Deficiencies in Reinsurance Collateralization Devices

a. Single Creditor Collateralization Devices

Probably as a result of their highly structured nature, single creditor collateralization devices have served their purpose reasonably well. In an insolvency context, however,
a number of detailed issues continue to undergo refinement and are the subject of litigation. For example, some reinsurers have attempted to block ceding companies from drawing down letters of credit or executing on collateral securing the letter of credit within the four month voidable preference time period.\textsuperscript{35}

In \textit{Pine Top Ins. Co. v. Bank of Am.},\textsuperscript{36} the Seventh Circuit held that an insurer did not create a voidable preference when it drew down a reinsurer’s line of credit during the four month period preceding the reinsurer’s insolvency.\textsuperscript{37} The dispute in \textit{Pine Top} arose when, in early 1986, Pine Top Ins. Co.’s (“Pine Top”) reinsurance reserves fell from $12.6 to $1.8 million.\textsuperscript{38} As a condition of conducting any further business, Republic Western Insurance Company (“Republic”) and Century Indemnity Company (“Century”), two of Pine Top’s reinsurance clients, required Pine Top to establish a standby letter of credit to secure its reinsurance obligations.\textsuperscript{39} In an effort to resuscitate Pine Top’s reinsurance business, Pine Top’s parent company, acting on Pine Top’s behalf, obtained a $10 million letter of credit from the Bank of America National Trust and Savings Association (the “Bank”).\textsuperscript{40}

The facts of the case revealed that the bank issued the letter of credit several weeks before it received any collateral.\textsuperscript{41} The efforts to revive Pine Top were unsuccessful and Republic and Century subsequently drew upon the full amount of the Pine Top letters of credit.\textsuperscript{42} During the liquidation proceedings, the trustee for Pine Top’s creditors brought a diversity action claiming that the draw downs by Republic and Century were voidable.\textsuperscript{43} The Seventh Circuit

\textsuperscript{35} \textit{Unfinished Business}, supra note 7, at 78.

\textsuperscript{36} 969 F.2d 321 (7th Cir. 1992).

\textsuperscript{37} \textit{Id.} at 325-29 (holding that the transfer of a security interest was “substantially contemporaneous” with the creditor’s letter of credit and therefore not a voidable preference).

\textsuperscript{38} \textit{Id.} at 323.

\textsuperscript{39} \textit{Id.}

\textsuperscript{40} \textit{Id.}

\textsuperscript{41} \textit{Id.}

\textsuperscript{42} \textit{Id.}

\textsuperscript{43} \textit{Id.} at 323-34.
held that the draw upon Pine Top’s letters of credit fell "squarely outside the justification for voiding . . . transfers," reasoning that the collateral offered was issued substantially contemporaneously with the issuance of the letter of credit and not for an antecedent debt. It is likely that these and other similar issues will continue to arise concerning the uses of single creditor trust devices. Such litigation, however, should not undermine the basic efficacy of these devises.

Conversely, the U.S. Congress’ assessment of single creditor collateralization devices poses a much greater threat to the validity of these devices. The U.S. Congress has been highly critical of the collateralization practices of several single creditor trusts. A House of Representatives committee report focused on four insurance insolvencies and cited numerous instances where trust or letter of credit assets were insufficient to pay the claims due from the reinsurer.

Since the size of the collateralization device depends on the losses reported by the ceding company, the failure to fully reserve by the ceding company may have been the more proximate cause of the problem. Once the ceding company reported its true liabilities, the reinsurer could understandably be skeptical about further requests for increased amounts of

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44 Id. at 326-29.
45 Id. at 328. A similar situation arose in In Re: The Receivership of Southeastern Casualty and Indem. Ins. Co., No. 89-2855, (Fla. Cir. Ct. Leon County 1991), when a receiver for an illiquid reinsurance company blocked an insurance company’s complete draw down of the illiquid reinsurer’s letter of credit within the voidable preference and fraudulent conveyance periods. Id., reprinted in 2 MEALEY'S LITIGATION REPORTS INSURANCE INSOLVENCY No. 22, at F-1, F6 to F-8 (Apr. 17, 1991). In this case, the reinsurer, as a condition of conducting business, was required to post a $1,000,000 letter of credit in favor of the ceding insurer. Id. at F-3. In July of 1989, the insurer made a demand on the reinsurer for the payment of three bonds, totally $314,000. Id. at F-3 to F-4. When the reinsurer failed to make payment on the bonds, the reinsurer attempted to draw down the entire $1,000,000 limit. Id. at F-5. The court found in favor of the receiver, holding that under these facts the transfer was both voidable and fraudulent. Id. at F7 to F8.

47 Id. at 2.
48 Id. at 60-61, 69-70.

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collateral and could be driven out of business. As a result, the problem may be more a result of the faulty manner in which financially troubled ceding companies calculate their reserves than a flaw in the functioning of single creditor collateralization devices.

b. Multiple Creditor Devices: Lloyd's American Trust Fund

The most prominent example of a multiple creditor collateralization device is the Lloyd's American Trust Fund ("LAT") and related trusts. Given the unique nature of these trusts and their relative importance in the field of collateralization devices, they will be reviewed in some detail below.

i. Liabilities Secured by the LAT

Section 1(D) of the Model Act requires that the LAT be maintained "for the payment of the valid claims of its United States policyholders and ceding insurers" equal to an amount "representing the group’s liabilities attributable to business written in the United States" plus $100 million. Therefore, on its face, the Model Act seems to require that the Names at Lloyd's ("Names") maintain, at a minimum, amounts equal to their liabilities to U.S. policyholders and ceding companies, plus $100 million, in the LAT. In reality, however, this is not how the assets placed in the LAT are calculated.

By definition, the LAT applies to "American business," or

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49 The size of the collateral is intended to match the ceding company's liabilities. If the ceding company under-estimates or under-reports liabilities while it is in financial difficulty, there will be insufficient collateral to cover such liabilities. If the ceding insurer becomes insolvent and the under-reserving is corrected, the reinsurer may be asked for more collateral in a very short time period. This could make the reinsurer skeptical about the veracity of the insuring company's new reserve figures.

50 See Unfinished Business, supra note 7, at 75.
51 See Appendix A.
52 Model Act, supra note 6, § 1(D).
53 Id.
54 Id.
55 Investors in Lloyd's are referred to as "Names."
56 Model Act, supra note 6, § 1(D).
those accounts where premiums are payable, or liability is expressed, in U.S. dollars. Because this definition is predicated on the use of U.S. currency, it fails, in some instances, to capture all the business written in the United States, while in other instances it encompasses business not related to the United States. Thus, the LAT definition is too narrowly (or broadly) tailored in relation to the Model Act. For example, the LAT definition is under-inclusive when it fails to capture accounts written in the United States that utilize foreign currencies. Similarly, the definition is too broad when it regulates accounts written in U.S. currency that have no relation to the United States.

Obvious concern arises when the LAT definition fails to capture the full amount of American liabilities, because such a narrow definition results in insufficient assets to collateralize liabilities. Unnecessary breadth is problematic because it is difficult for U.S. creditors and regulators to: (1) understand what business is secured by the trust; (2) evaluate the liabilities related to such business which are secured by the trust; and (3) determine whether an adequate correspondence exists between liabilities and the assets meant to secure assets. If the reserves for non-U.S. business are inadequate, claims by foreign creditors can dilute the amounts available to U.S. creditors. United States creditors will have to engage in a "race to the courthouse" with foreign creditors over assets meant to collateralize U.S. obligations. United States creditors with unliquidated or contingent claims may find no funds remaining by the time their claims mature. The scope of the LAT simply does not match the requirements of the Model Act.

ii. Amount of the LAT Assets

The LAT is intended to secure U.S. obligations. To serve its intended purpose, therefore, the trust must contain

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57 See Appendix A (defining "American business").
58 See id.
59 Because of a lack of disclosure, regulators may be unable to review the LAT to ensure that it contains the assets required by the Model Act. See Appendix A (Art. 6(A)); See Model Act, supra note 6, § 1(D).
60 See Appendix A.
sufficient assets to meet the amount of incurred obligations. Section 1(D)(1) of the Model Act requires that the trust consist of "the group's liabilities attributable to business written in the United States . . ." In apparent contradiction to the Model Act, the LAT assets are net of reinsurance recoverables. The revelation of this fact in mid-1994 created considerable consternation for both regulators and creditors who previously understood the trust's value to be equal to its gross liabilities.

There are several critical problems with a trust that is net of reinsurance recoverables. First, no assurances exist that the reinsurance provided meets either U.S. standards for creditworthiness or U.S. accounting standards for treatment of reinsurance. In the past, various syndicates have used "time and distance" reinsurance contracts which delay

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61 Model Act, supra note 6, § 1(D).

62 Use of the unqualified term "liabilities" does not suggest the term refers to liabilities minus reinsurance recoverable or any other factor. If reinsurance recoverables are to be deducted, then there must be a review of the credit-worthiness of the reinsurers to determine the likelihood that they will meet their obligations. Likewise, a review of the transaction should be conducted to assure it meets proper U.S. accounting standards for treatment as reinsurance. Recoveries overdue or in dispute would have to be identified and excluded from the credits. In addition, a general charge for uncollectibility should be considered akin to the Risk Based Capital calculations in the United States. The initial point is obvious: "liabilities" does not mean "liabilities minus some factor that the party obligated to post the trust chooses to use to reduce the size of the trust."

The second point is that adding factors to and subtracting factors from "liabilities" requires the imposition of U.S. legal and accounting rules on the transactions of the reinsurer posting the trust. The reason why the reinsurer is posting the trust is that it does not wish to be subject to these legal and accounting rules in the first place. Therefore, the answer to this line of inquiry is that the reinsurer should become licensed or accredited in the United States if it chooses not to comply with collateralization requirements.

63 Meg Fletcher, U.S. Regulators Step Up Oversight of Lloyd's, BUS. INS., Aug. 29, 1994, 42, 43-44.

64 The NAIC Reinsurance Working Group believes that the LAT should contain gross liabilities without netting of reinsurance recoverables. The chair of the Working Group stated "that it had always been his understanding that the reference (liabilities) was to the reinsurer's gross liabilities arising from U.S. business, with no consideration of retrocessional arrangements . . ." NAIC Proceedings, 1994 (quotation taken by author at 1994 NAIC meeting). In reaction to the revelation about the LAT, the Working Group voted to clarify the Model Act by specifying that liabilities should reported as a gross figure. Id.
recognition of losses but do not transfer underwriting or other risk.\textsuperscript{65}

Finally, reinsurance recoverables are the underwriter's property. If the underwriter becomes insolvent, the trustee for the underwriter's creditor should be able to collect reinsurance recoverables. These recoverables, however, would be available to satisfy all of the underwriter's debts and not merely the debts on U.S. business.\textsuperscript{66} As a result, the net LAT trust requirements are significantly inferior to those found in the Model Act.

iii. Auditing Net Liabilities

Unfortunately, no apparent mechanism exists to assure that net assets in the LAT are sufficient to cover net U.S. liabilities. Names are audited annually to determine whether they have sufficient assets in trust to meet their world wide liabilities.\textsuperscript{67} There are, however, other premium trusts in Canada and the United Kingdom. Similarly, these trust's auditing processes do not match assets and liabilities.\textsuperscript{68} As a result, a Name will pass the auditing process even if a deficiency in the LAT exists, so long as an offsetting surplus

\textsuperscript{65} The delay in recognition of losses may give a false impression of the actual liabilities which need to be collateralized.

\textsuperscript{66} Reinsurance recoverables are pooled into one large fund to benefit all creditors of a particular class. No distinction is made with regards to a creditor's location. Therefore, foreign creditors have the same rights to reinsurance recoverables as domestic creditors.

\textsuperscript{67} See Central Fund Byelaw No. 4 (1986), reprinted in 4 LILLY'S ABRIDGMENT II-180 to II-181 (Sept. 10, 1992).

\textsuperscript{68} Section 83 of the Insurance Companies Act of 1982 requires that a trust audit disclose whether the value of trust assets are sufficient to meet insurance and reinsurance liabilities. Insurance Companies Act of 1982, ch. 50, § 83 (Eng.). The audit requirements do not mandate that particular trust assets be matched with liabilities. \textit{Id.} The U.K. Department of Trade and Industry ("DTI") requires that a Name maintain in trust the greater of either a percentage of net premiums for each class of business written or a best estimate of the syndicate's liabilities. The DTI recently increased the minimum standard, particularly on U.S. business and this may increase the losses to Names for the 1991 underwriting year. Stacy Shapiro, \textit{Syndicates Balk at New Solvency Measure}, BUS. INS., Mar. 7, 1994, at 51, 51-52. By 1994, over 5000 Names had inadequate funds backing their obligations. Graeme King, \textit{Questions and Answers}, THE SON, Apr. 1994, at 4. Nearly 1500 additional Names applied to Lloyd's for hardship status, while another 179 declared bankruptcy or entered a voluntary arrangements. \textit{Id.}
remains in another trust account.

While the LAT assets requirement may provide Lloyd's with sufficient evidence of a Name's assets, the requirements provide little assurance for U.S. creditors and regulators. Although U.S. regulators have the authority to examine the trust, as a matter of practice, such authority has not been utilized. Moreover, Article Six of the LAT specifically prohibits U.S. creditors from obtaining the information necessary to match assets in the trust with obligations owed to those creditors.

If an annual audit reveals a deficiency in the LAT and the appropriate Names decline or refuse to correct the deficiency, the Central Fund at Lloyd's may "earmark" assets to offset the deficiency. The amounts earmarked by the Central Fund have increased significantly over the last two years. In

69 See Model Regulation, supra note 8, § 7(c)(3).

70 In 1994, New York State's Insurance Department became the first U.S. regulatory agency to investigate LAT. Fletcher, supra note 63, at 42.

71 See Appendix A (Art. 6(A)).


73 At the end of 1993 the LAT's balance was £903,662,000, as compared to a 1992 balance of £1.1 billion. ANNUAL REPORT AND ACCOUNTS 1993, LLOYD'S OF LONDON 38 (1994). The amounts earmarked for the Central Fund increased from £354,900,000 in 1992 to £661,600,000 million in 1993. Id. at 43. The actual claims paid out to cover unfunded cash calls increased from £44.1 million in 1992 to £312.2 million in 1993. Id. at 37. The Central Fund had an operating deficit of £567,800,000, whereas in 1992, the fund operated at a £219,900,000 surplus. Id. at 40.

Since the assets required by the DTI solvency test for 1992, as calculated in August 1993, exceeded the Central Fund's assets, Lloyd's had to utilize its corporate assets had to cover the deficit. Adrian Ladbury & Stacy Shapiro, Lloyd's Clears Solvency Test, Now Going After Members' Debt, BUS INS., Sept. 19, 1994, at 82. To pass the solvency test for 1993, Lloyd's had to include the Lloyd's building as an asset and £180 million of estimated double counting of losses. Id. Many critics have noted that the difficulty in collecting outstanding balances from Names, when combined with continuing losses from past years, presents a serious problem for the Central Fund in 1995. Gleeson, supra note 72, at 33. "The reluctance of Names to contribute to the funds means that "earmarking" can be expected to exceed Central Fund and all other assets next year." Id.

Christopher Stockwell, chairman of the Lloyd's action groups, has commented: "[T]he amount of £180 million is technically solvent now, but I don't see how they'll get through solvency this year. . . . Names who are earmarked are bust and they're not going to pay any money." Clare Sambrook, Names Claim That Lloyd's Could Face Insolvency', DAILY TELEGRAPH, Apr. 25, 1994, at 20. Mr. Stockwell went on to note that Lloyd's covered sums owed
addition, the Central Fund supports a variety of other causes, thereby impairing the ability of the Central Fund to meet shortfalls in the LAT.\textsuperscript{74} The legal implications of "earmarking" are unclear. Earmarked funds do not necessarily have to be set aside to meet corresponding debt obligations.\textsuperscript{75} Nor does earmarking require that a contribution be made to the LAT by the Central Fund, nor does the failure to do so even give rise to a right of action against the Central Fund for U.S. creditors.\textsuperscript{76} Furthermore, the Central Fund's obligation under this debt remains entirely discretionary.\textsuperscript{77} Robert Hiscox, Deputy Chairman of Lloyd's, confirmed that Lloyd's is under no obligation if NewCo.\textsuperscript{78} becomes illiquid. Mr. Hiscox has noted:

by about 7,500 members last year and this year it is likely that it will have to stand for more than 10,000. \textit{Id.}

\textsuperscript{74} The Central Fund subsidizes Lioncover, which is a vehicle to reinsure 73 syndicates with disastrous results, primarily from long tailed casualty business. Through the end of 1993, the Central Fund had contributed £231,000,000 to cover deficient loss reserves with further reserve deterioration likely. \textit{See} 1993 ANNUAL REPORT, \textit{supra} note 73, at 46. In addition, these syndicates have £477,000,000 in questionable reinsurance recoveries. \textit{Id.}

The Central Fund also subsidizes CentreWrite which provides stop loss reinsurance to syndicates in run-off and individual Names. \textit{Id.} A £21,200,000 subsidy was required to fund CentreWrite's deficiencies in 1993. \textit{Id.} The Central Fund provides funds for hardship arrangements for Names in financial difficulty. \textit{Id.} In addition, Central Fund was willing to contribute a reported £400,000,000 to the unsuccessful effort to settle the Names litigation against Names' agents and managing agents. \textit{Planning for Profits: A Business Plan, Apr. 1993,} at 38-9, 64-65 [hereinafter Business Plan].

\textsuperscript{75} Central Fund Byelaw No. 4 (1986), \textit{reprinted in 4 LILLY'S ABRIDGMENT II-175 (Sept. 10, 1992)} [hereinafter Central Fund Byelaw No. 4].

\textsuperscript{76} \textit{Id.}

\textsuperscript{77} \textit{See id.} The Byelaw requires that: "Monies out of the Central Fund may be applied and the Central Fund may be charged for any of the following purposes: . . . (d) Extinguishing or reducing the liability of any member of the Society to any person whatsoever, whether or not arising under a contract of insurance." \textit{Id.} at II-177 (emphasis added). This byelaw would seem to allow use of the Central Fund to extinguish any debt of a Name, regardless of whether or not related to insurance or reinsurance obligations.

The Central Fund is not an automatic trigger. There's nothing in the Lloyd's Act of 1982 that states that if one syndicate fails, or if one member fails, another has to step in to pay their debts. . . [T]he Council [of Lloyd's] . . . would have to decide whether it was in the best interests of the Society that Lloyd's continue to pay every valid claim. . . [If the worst happens,] all I can say is the American insurance industry would be dead.\(^7^9\)

Presumably, other U.S. creditors would fare no better.

iv. Several Nature of LAT

Section 1 (D)(1) of the Model Act and Section 7 (B)(2) of the Model Regulation\(^8^0\) require that the LAT equal aggregate liabilities attributable to U.S. business plus $100,000,000 held jointly for the benefit of ceding companies. Aggregate liabilities are much larger than $100,000,000.\(^8^1\) As a result, the vast majority of the funds in the LAT are held on a several

\(^7^9\) Lisa S. Howard, Lloyd's Struggles To Put Value On Tail Claims, NAT'L UNDERWRITER, Mar. 28, 1994, at 1 [hereinafter Howard Lloyd's Struggles]. But see Lloyd's Warning, THE TIMES, Apr. 25, 1994, at 41 (paraphrasing comments of Peter Middleton, chief executive of Lloyd's, connecting the failure of NewCo. with that of Lloyd's). Mr. Middleton's believes that the Department of Trade and Industry or the U.S. Securities and Exchange Commission would close Lloyd's if NewCo. failed. Id.

One author has noted:

If NewCo. goes down for the count, the new Lloyd's will not escape. American policy-holders who remain unpaid would try to seize the billions of dollars held on behalf of Names in Lloyd's American trust funds. They would also seek the backing of the British courts, adding to the vicious spiral of legal actions that has already so damaged the market's reputation. . . The new Lloyd's may believe that it is immune from the problems of the past, but it is likely to find that the ring-fence provides at best only partial protection.


\(^8^0\) See Model Act, supra note 6, § 1(D)(1); Model Regulation, supra note 8, § 7(B)(2).

\(^8^1\) As of December 31, 1994 the LAT assets equaled $8,719,000,000. Security Underlying Policies Issued at Lloyd's, LLOYD'S OF LONDON, June 1993. It has been reported more recently that the size of the LAT is $9.55 billion. See Meg Fletcher, Lloyd's Gets Closer Look: U.S. Policyholders, Regulators Reassess Market Security, BUS. INS., Mar. 21, 1994, at 1.
basis. Each Name posts funds for its own liabilities and has no obligation for the liabilities of other Names.

As noted above, the LAT's aggregate value does not include full liabilities. Moreover, the Council of Lloyd's does not require each Name to have a net LAT assets value which matches its U.S. liabilities. Historically, U.S. regulators have failed to monitor the adequacy of the LAT funds and the creditors are prohibited by the LAT from obtaining the information necessary. As a result, it is possible that an

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52 Lloyd's Insurance Market: Facing the Financial Challenges of the 1990's, Moody's Special Comment, Oct. 1993, at 5-6 [hereinafter Moody's].

There is not, for example, a single, giant Lloyd's American Trust Fund of US $8.7 billion. Instead, there are several hundred separate Lloyd's Trust Funds containing wholly-segregated assets, which, as of December 31, 1992, would have totaled US $8.7 billion if added together. . . . At the end of the three years, any premium and investment income that has not already been used to pay claims and claims expenses will be repatriated as a contribution to the overall result for the syndicate's Names. U.S. policyholders therefore need to be aware that they have recourse only to the trust funds and Names relating to the syndicate or syndicates that have provided them with cover. U.S. policyholders have never had access to the global value of the market's trust funds and Names as if they comprised a single, corporate claims reserve.

53 See id. at 5.

54 See supra note 64 and accompanying text.

55 See Appendix A (Art. 3).

56 See G. Larry Engel, Selected Issues for Policyholders (Including Ceding Insurers), in Securing Meritorious Claims Being Disputed by Lloyd's or Other Alien Insurers, Solvency Concerns with Foreign Insurers and Reinsurers/Recent Developments/U.S. Reform Efforts E-10 (ABA ed. 1994) (noting that U.S. regulators do not have the resources to monitor trust balances).

57 Article 6 of the LAT reads as follows:

Nor even after his claims becomes enforceable as herein defined, shall any policy holder be entitled to require from the American Trustee any account, or otherwise to inquire into the course of administration of the trusts relating to the American Trust Fund, or to question any act for thing done or suffered by the American Trustee, or otherwise to enforce such trusts, the sole right under the American Trust Deed of such policy holder being to receiver the amount of his claims after its has become enforceable as herein defined from the assets of the American Trust fund then actually in the hands of the American Trustee and available for such payment as provided in subdivision (C) of this Article.

See Appendix A (Art. 6).

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individual Name will have insufficient LAT funds to cover its U.S. obligations. Such a scenario could occur if the Name: (1) has posted liabilities minus reinsurance recoverables; (2) maintains funds in another trust; (3) has become financially impaired, insolvent or dissolves; or (4) employs reinsurance-to-close ("RITC") and removes its funds from the LAT.

v. Debts Paid by the LAT

As one would expect, the assets in the LAT are designed to pay losses, claims and return of premiums. The LAT, however, has many other permitted uses that undermine the security of U.S. creditors. Articles Five and Fourteen of the LAT authorize that trust assets may be utilized for: (1) a first lien held by the trustee for remuneration of expenses and counsel fees; (2) salary, commission, brokerage or other remuneration due to a Name's agent or any other person; (3) any expenses of such an agent in connection with the underwriting business of a Name, whether a U.S. business or not; (4) any expenses of an agent in connection with the termination of the underwriting business of a Name, whether a U.S. business or not; and (5) reinsurance premiums.

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88 RITC is a reinsurance mechanism that permits a ceding company to lay off its excess liability to another or successor syndicate. The ceding company lacks privity with the RITC syndicate and therefore has no legal redress to collect any funds posted by the RITC syndicate. The original Name, although remaining liable for the LAT deficiency, may lack the necessary funds required for collection. See A GUIDE TO CORPORATE MEMBERSHIP, LLOYD'S OF LONDON, 24-25 (1993) [hereinafter CORPORATE MEMBERSHIP].

89 The trustee has a "first lien" on the assets of the trust to pay the trustee's remuneration, expenses and counsel fees. See Appendix A (Art. 14). Because the trust's purpose is secure policyholders and ceding companies' payments, it is inappropriate to pay other obligations out of the trust and illegitimate to grant priority to those particular expenses via a vis the trust's obligation to policyholders and ceding companies. See Model Regulation, supra note 8, §10(b)(9) (relating to single creditor trusts). Moreover, it would seem especially inappropriate to pay the legal expenses incurred in resisting the claims of beneficiaries of the LAT.

90 One commentator has suggested that funds could be removed from the LAT to pay defense costs as priority expenses assessed in tort litigation between a Name and one of its agents. See Engel, supra note 86, at E-12.

91 It has also been suggested that the LAT funds could be used to pay for the Name's reinsurance, which would make both the reinsurance premiums and reinsurance proceeds inaccessible to U.S. creditors. Id. at E-13.
Those familiar with single creditor collateralization devices, which prohibit payments for extraneous expenses,\(^\text{92}\) may find it alarming that the LAT permits a Name to draw on collateralized assets for operating expenses. It is questionable whether this device meets the letter and spirit of the Model Act and Model Regulation.\(^\text{93}\) Clearly, there should be a rule assuring regulators and creditors that sufficient assets exist to pay trust obligations to policyholders and ceding companies.

vi. Mechanics of the LAT

The mechanics of the LAT raise further problems. For example, Article Six of the LAT provides a mechanism for policyholders to make a claim against trust assets, but provides no similar remedy for ceding companies.\(^\text{94}\) While "policyholders" may encompass both types of creditors in the United Kingdom, this is not necessarily the case in the United States.\(^\text{95}\)

Additionally, other problems arise during collection. Under Article Six, a creditor must wait thirty days after filing a final (i.e., after all appeals have been resolved) judgment before it receives any amount owed from the trust.\(^\text{96}\) During that thirty day period, a Name is authorized, pursuant to Article Five, to draw on some, or all, of the LAT funds.\(^\text{97}\) Thus, a U.S. creditor could be deprived of its remedy after years of

\(^{92}\) See Model Act, supra note 6, § 2; Model Regulation, supra, note 8, §§ 9, 10.

\(^{93}\) See generally Model Act, supra note 6; Model Regulation, supra, note 8, (stating the Act and Regulation's purpose is to protect the public interest and comply with pre-existing laws and regulations).

\(^{94}\) See Appendix A (Art. 6).

\(^{95}\) See e.g., In Re Liquidations of Reserve Ins. Co., 524 N.E.2d 538 (Ill. 1988). The court in Reserve held that reinsurers were not policyholders for purposes of the priority of distribution of assets of an insolvent company's estate. \textit{Id.} at 542. Similarly, the petitioner's brief in the case of In Re Laurencio Jaen Ocana utilized the "policyholder" argument as part of its defense against a ceding insurer, who sought to attach assets placed in a LAT-type trust. Reply Brief at 14, In Re Laurencio Jaen Ocana, 151 B.R. 670 (S.D.N.Y. 1993) ) (No. 91-B15233) (on file with author). The court found it unnecessary to pass on the policyholder argument. See Laurencio 151 B.R. at 673. It is undesirable to await the default of one or more syndicates to find out whether they would make the same argument.

\(^{96}\) See Appendix A (Art. 6).

\(^{97}\) See Appendix A (Art. 5).
litigation.

There is nothing in the LAT that specifies the nature or quality of the investment of the assets of the trust. Given recent investment related receiverships, asset quality is an issue of every increasing importance for regulators and creditors. Another problem exists because, although Article Eleven of the LAT requires the trustee to provide an account of its actions to the Name's agent, such disclosure is ineffectual. Approval by the Name's agent completely discharges the trustee's obligations to any party, including the beneficiaries of the trust. Furthermore, the agent does not assume or indemnify the trustee's liabilities, but rather nullifies the obligations. It is unclear what authority the agent has to discharge beneficiaries' claims held against the trustee for misconduct in handling the trust.

Finally, unlike the Model Act and Model Regulation, the LAT does not grant the insurance commissioner of a respective state the authority to examine the trust. Similarly, the LAT does not require the trustee to make any disclosures to a state's insurance commissioner.

Theoretically, the gaps between the trust language and the relevant statutes and regulations could be resolved if regulators made use of their powers to review and approve the terms of the trust under the Model Act. Regulators owe such a duty to U.S. creditors and this duty has not been

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98 Section 1 of the Model Act and Section Seven of the Model Regulation require the Name to disclose prior-year investments. Model Act, supra note 6, §1(D)(4); Model Regulation, supra note 14, §7(C)(5). The insured has little recourse ex ante, however, to cure a past investment mishap.

99 For example, these include Executive Life Insurance Company (junk bonds) and Mutual Benefit Life Insurance Company (real estate).

100 See Appendix A (Art. 11).

101 See Appendix A (Art. 13).

102 See, e.g., Model Regulation, supra note 8, § 10 (B)(10) (requiring that the trustee of a single creditor collateralization device be liable for its own negligence, willful misconduct or lack of good faith).

103 Model Act, supra note 6, §1(D); Model Regulation, supra note 8, §7(C). Both provisions grant state insurance commissioners the authority to examine the trust.

104 See Model Act, supra note 6, § 1(D)(4) (requiring that disclosure of the trust balance and the nature, quality, and quantity of its investments be made by February 28th of the following calendar year).

105 Model Act, supra note 6, § 1(D)(3).
fulfilled. In a broader sense, it is clear that the LAT suffers badly in comparison with single creditor collateralization devices when viewed from a creditor standpoint. Some regulators and industry commentators may be correct to suggest that multiple creditor collateralization devices should be eliminated, they provide poor security and are inadequate substitutes for single creditor devices.

Alternatively, the Model Act and Model Regulation could be amended to make multiple creditor collateralization devices more viable. These changes, when combined with actual enforcement of the law, would have substantial benefits for U.S. creditors. The following subsection presents such proposed changes to the Model Act and Model Regulation.

vii. Remedial Measures

First, the Model Act and Model Regulation should incorporate investment guidelines that would assume that the assets placed in trust will not become valueless.\(^{106}\) Second, the Model Act and Model Regulation should be amended to limit the definition of LAT liabilities to include only obligations to U.S. ceding companies and policyholders holding property or risks situated in the United States. Third, every Name should be audited annually and its U.S. liabilities and matching assets should be disclosed. Fourth, U.S. creditors should be authorized to obtain information regarding each Name's obligation due to that creditor. Fifth, to further reduce the risk that individual Names would have insufficient assets to meet their obligations, the LAT should make each Name jointly liable for the liabilities of all other Names.\(^{107}\)

\(^{106}\) States typically have stringent guidelines regulating the nature, quality and diversification of insurance companies' investment portfolio. See, e.g., N.Y. INS § 1401 (McKinney's 1994) (Definitions); N.Y. INS. § 1402 (McKinney's 1994) (investment requirements); N.Y. INS. (McKinney's 1994) (minimum capital or surplus requirements).

\(^{107}\) Lloyd's representatives contend that Lloyd's operates on a several basis (i.e., in general, that no Name is responsible for the debts of another) and that an act of Parliament would be necessary to turn the LAT from a several fund to a joint trust. Such a representation is inconsistent with the mutualization of Names' liabilities represented by such facilities as Lioncover. See 1993 ANNUAL REPORT, supra note 73, at 46. Lloyd's contention is also inconsistent with the fact that Lloyd's owns several corporations including two limited liability insurers, four publishing companies, a pension and a securities corporation, and various managing
extent that one Name subsidizes another, Lloyd's can make appropriate adjustments between Names through the Central Fund or similar device. This would produce a more efficient collateralization device and would better secure creditors.

Absent such a move to a joint fund, other alternatives should be explored to reduce the risk of deficiencies: (1) RITC syndicates should be required to deposit funds in the LAT to match liabilities of Names which have been assumed by the RITC syndicates; (2) U.S. creditors should have information about, and a right of action against, assets posted by such RITC syndicates; and (3) in the event that the assets in the LAT are insufficient to meet the obligations of a U.S. creditor, the creditor should have a direct right of action against funds "earmarked" by the Central Fund to correct such deficiencies. Furthermore, the LAT should not be used to pay expenses extraneous to obligations to U.S. creditors. Section Two of the Model Act and Section Ten of the Model Regulation are appropriate models for any amendments to LAT.

c. Reinsurance Trust Fund

The reinsurance trust fund has many similarities to the LAT, and a number of the problems which are contained therein are commented upon in Section 2.4(b). These comments will not be repeated here.

and members' agents. See id., at 28. It is inconsistent with the recent establishment of two joint funds in the United States: the Lloyd's American Credit for Reinsurance Joint Asset Trust and the Lloyd's American Surplus or Excess Lines Insurance Joint Asset Trust. See Lloyd's American Credit for Reinsurance Joint Asset Trust Deed, Agreement Between Lloyd's of London and Citibank, N.A., Art. 2 (Sept. 15, 1993) (unpublished agreement, on file with author) [hereinafter RJAT]. In addition, Lloyd's has many other collateralization devices operating on the basis of joint liability. See A Guide to Corporate Membership, LLOYD'S OF LONDON, Sept. 1993, at 22 [hereinafter Corporate Membership]. Lloyd's describes one device as one by which: "[A]ssets deposited are available to cover liability on any Lloyd's policy in the relevant jurisdiction, notwithstanding that the deposit established in that jurisdiction may have been funded in part by members who are not responsible for those liabilities." Id. Specifically with respect to the LAT, managing agents may loan a Name's deposits "to other members (on the same or another syndicate), to enable them to meet their underwriting liabilities for a current or previous year of account." Id. at 21. It is therefore evident that Lloyd's can and has found ways to make collateral accounts operate on a joint basis when it is motivated to do so.
i. Effective Dates of the Reinsurance Trust

In 1990, the NAIC amended Section 1 (D)(1) of the Model Act to require a surplus in the amount of $100,000,000 to be held jointly in trust for the benefit of U.S. ceding insurers.108 Effective September 15, 1993, Lloyd's established the Lloyd's American Credit for Reinsurance Joint Asset Trust Deed ("RJAT").109 The RJAT presents a detailed description of the management of the trust110 and the methods by which a claimant may proceed to recover under the trust.111 Nevertheless, the RJAT is unclear as to when a claim must be brought in order for it to be covered.112 There is some suggestion that it would apply only to claims on contracts issued during the term of the RJAT.113 This would create a gap between the effective date of the RJAT and an earlier date upon which a state adopted the amended statutory language.

The implications of such a gap are significant for ceding companies. If this trust fell under Section Two of the Model Act, a ceding company would have to increase its liabilities by any shortfall in the trust.114 The LAT, however, falls under Section One of the Model Act. Section One denies credit (i.e., an increase in assets or decrease in liabilities) for reinsurance ceded to a reinsurer that does not qualify under that section.115 If this situation is not corrected, or if the intent

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108 See Model Act, supra note 6, § 1(D)(1).
109 See RJAT, supra note 107.
110 See id. § 2.6.
111 See id. § 2.3.
112 For instance, does the RJAT cover claims which arose: (a) at any time; (b) after the relevant state adopted the $100,000,000 joint trust requirement; or (c) after the RJAT was established? The RJAT is ambiguous on these points.
113 See id. § 2.14(a). This Section concerns the trustee's duties on termination of the trust. One duty is to obtain an auditor's report of the losses and unearned premiums on reinsurance contracts "issued during the term of the Trust" as a means of determining final payment from the RJAT. See id. This suggests that the RJAT only applies to claims on reinsurance contracts issued subsequent to September 15, 1993 (the date the parties deemed the RJAT effective). Id.
114 "A reduction from liability . . . shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer and such reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust . . . ." See Model Act, supra note 6, § 2.
115 Section 1 (D)(1) of the Model Act states that: "Credit shall be allowed
of the RJAT is not clarified, regulators may deny all credit for reinsurance ceded to Lloyd's during this gap. In addition, Section 2.1 of the RJAT allows the trust to terminate under various circumstances.\textsuperscript{116} Therefore, the RJAT directly contradicts the mandate of section 1 (D)(3) of the Model Act, which prohibits termination of the trust as long as there are any “outstanding obligations due under the reinsurance agreements subject to the trust.”\textsuperscript{117}

ii. Types of Claims Covered by the RJAT

The RJAT requires trusts to pay claims on an “American Reinsurance Policy,”\textsuperscript{118} which is defined as reinsurance “with respect to property or risks situated in a state, district, territory, commonwealth or possession of the United States provided that such Policies shall not include life reinsurance.”\textsuperscript{119} Because the Model Act includes life insurance, its exclusion from the RJAT jeopardizes credit for reinsurance on all life insurance business ceded to Lloyd's.

In addition, the Model Act does not limit exposure of the $100,000,000 trust to the domestic risks of domestic ceding companies - it includes all risks of domestic ceding companies, whether or not located in the United States. This represents sound public policy since a U.S. ceding company may become insolvent by its inability to collect reinsurance on either non-U.S. or U.S. risks.

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\textsuperscript{116} For instance, a trust may be terminated for any reason after five years of inception. See RJAT, supra note 109, § 2.1. The termination of the trust is also allowed when the reinsurer: (1) becomes licensed in all states in which it is conducting business; or (2) enters into an assumption reinsurance agreement ceding all business covered by the RJAT to a licensed reinsurer. Id.

\textsuperscript{117} Model Act, supra note 6, §1(D)3.

\textsuperscript{118} Id. RJAT, supra note 107, § 2.3.

\textsuperscript{119} Id. RJAT, supra note 107, §1.1 (emphasis added).
iii. Trustee's Fees and Expenses

Similar to the LAT's structure, the trustee of the RJAT is given first lien on the assets in the trust, in this case up to ten percent of the assets. It is problematic to grant the trustee such a right since the purpose of the trust is to protect U.S. ceding companies. This is particularly true since the trustee can use the trust assets to resist the claims by trust beneficiaries. Requiring that the trustee be compensated from non-trust assets would serve better the intended regulatory purpose.

vi. Enforcing Claims Against the Trust

The RJAT contains claims procedures similar to those found in the LAT. There are, however, important differences between the RJAT claim procedures and those found in the LAT. For example, a creditor must exhaust its remedies against the LAT and the Lloyd's Central Fund United States Trust ("CFT") before collecting from the RJAT. In addition, the trustee is empowered to determine whether the claimant has complied with all preconditions to collecting proceeds, and the trustee's "determination shall be conclusive and binding on all parties."

There is no requirement in the Model Act or Model Regulation that a creditor exhaust remedies against the LAT or CFT before asserting rights against the RJAT. In addition, it is doubtful that a trustee who is compensated out of the trust should make a "conclusive and binding" determination as to whether a claimant can collect from the trust.

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120 Id. RJAT, supra note 107, §§ 2.2, 3.9.
121 Section 10 (B)(9) of the Model Regulation prohibits the trustee from invading the any trust established under § 2 of the Model Act on his or her own behalf. See Model Regulation, supra note 8, §10(B) 9. Similar language could be applied to trusts established under § 1 of the Model Act.
122 See supra Section 2.3(b).
123 See RJAT supra, note 107, § 2.3(d).
124 Id.
v. Remedial Measures

Many of the RJAT's shortcomings (which have not already been addressed with respect to the LAT) appear to be the result of drafting errors.\textsuperscript{125} Some of the other shortcomings are created by provisions that do not conform to the letter or intent of the Model Act and Model Regulation.\textsuperscript{126} Therefore, should regulators exercise their authority to approve amended language to the RJAT, so that it would comply with the terms and spirit of the Model Act and Regulation. Many of the remedial measures noted in Section 2.3(b)(vii) are equally applicable to the RJAT.

d. U.S. Central Fund Trust\textsuperscript{127}

The CFT is not required by any state law or regulation. It was formed on July 17, 1992 for reasons that are not evident in the document.\textsuperscript{128} Its principal is not tied to a specific dollar amount or to liabilities. Article 2\textsuperscript{129} states that the principal is to consist of Central Fund contributions paid out of the LAT and other amounts transferred to the trustee.

Article 4 (C)\textsuperscript{130} of the CFT allows the trustee to transfer out of the CFT any assets in excess of those necessary to collateralize U.S. liabilities (as calculated in conjunction with LAT assets).\textsuperscript{131} The LAT is required to maintain a balance equal to liabilities.\textsuperscript{132} This suggests two possible problems with the CFT: (1) there are no funds in the CFT; or, (2) the LAT is under-funded.\textsuperscript{133} The first alternative means that the CFT adds no security to U.S. creditors while the other means the LAT is not in compliance with the Model Act. The

\begin{footnotes}
\item[125] See supra Section 2.3(b)(i)-(vi).
\item[126] See supra Section 2.3(b)(i)-(vi).
\item[127] Lloyd's Central Fund United States Trust Deed, Agreement Between Lloyd's of London and Citibank, (July 17, 1992) (unpublished agreement, on file with author) [hereinafter CFT].
\item[128] See id. § 17.
\item[129] Id. § 2.
\item[130] Id. § 4(C).
\item[131] Id.
\item[132] Lloyd's Central Fund United States Trust Deed, supra note 6, § (D)(1).
\item[133] See supra note 6, § (D)(1).
\end{footnotes}
principal of the CFT is to be used to: (1) pay defaults by Names on U.S. business; (2) prevent or reduce the extent of such a default; (3) compensate any person for making any payment which reduces the default of a Name; (4) pay the liability of any Name arising out of American business, whether or not arising out of a contract of insurance; and, (5) compensate the trustee.134

While the purpose of the CFT is unclear, much of its language mirrors that of the LAT and the RJAT, including language discussed in previous sections. Since there is no current regulatory requirement for the CFT, no regulatory recommendations are appropriate. If the LAT and RJAT are properly collateralized by and accessible to creditors, there would be no need for the CFT.

e. Impact of “Equitas” and the Lloyd’s Business Plan

Lloyd’s has suffered devastating underwriting losses in recent years. Losses have averaged £275,000 per existing Name for 1988-1991.135 In May 1994, Lloyd’s reported a loss of £2.05 billion136 for the underwriting year 1991137 which

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134 CFT, supra note 127, § 4.
136 This figure is net of £533 million for estimated double-counting of underwriting agents’ errors and omissions claims and personal stop loss and estate protection plan policies. Losses for 1991 include £1.14 billion in reserve strengthening for syndicates in runoff, compared to £678 million in 1990. See Diane Coyle, Lloyd’s Loss Has Names Facing New £1.7 Billion Bill, THE INDEPENDENT, May 18, 1994, at 27. Most of this reserve strengthening relates to asbestos, pollution and health hazard claims from the United States. One hundred and sixty-two of the 349 syndicates operating in 1991 were unable to close their books, bringing the total number of accounts in runoff to 478. Fiona Gibson, Global Results 1993, LLOYD’S OF LONDON, May 1994. Currently, there are 478 syndicates with open year representing a total stamp capacity of £12 billion. This is greater than the total market capacity of £11.4 billion for 1991, which has been the pinnacle of Lloyd’s capacity to date. Id. Chatset also believes that the 1991 estimate is low by over £500 million. See Helen MacLeod, ’91 Losses to Lloyd’s Names to Top Forecast, Analysts Say, J.COM., June 28, 1994, at A9.

Current-year losses were reduced from £937 million in 1990 to £615 million in 1991. See id. This factor, when considered in conjunction with the great increase in old year losses, suggests that Lloyd’s may have to choose between acceptable returns on current business and funding the old year losses. Corporate capital was attracted to Lloyd’s by the assurance that it would not be liable for old year losses.
brings losses since 1988 to approximately £8 billion.\(^{138}\) A £1 billion loss is projected for 1992 but a £300 million profit is projected for 1993 after deducting £500 million for old year reserve deterioration.\(^{139}\)

Many of these losses are emerging from "long tailed" U.S. business involving pollution and asbestos.\(^{140}\) Nearly forty-four percent of the £1.4 billion in deterioration is a result of pollution and asbestos losses.\(^{141}\) This percentage is increasing, suggesting that these losses have not peaked.\(^{142}\)

One financial analyst believes that Lloyd's is still £8.65 billion under-reserved, with £7.35 billion attributable to 1985 and prior year losses.\(^{143}\) Another analyst believes that the LAT is under-funded by $7.5 billion and that Lloyd's in general is under-reserved for asbestos and pollution alone by £11 billion, twice the proven means of the entire membership.\(^{144}\)

\(^{137}\) Lloyd's reports its financial results three years after the end of a calendar year. Stacy Shapiro, Lloyd's Hopes To Put The Past Behind It And Return To Profitability, BUS. INS., Aug 29, 1994, at 4.

\(^{138}\) See Gibson, supra note 136, at 1.

\(^{139}\) See Adrian Ladbury, Profitability in Sight for Lloyd's But Old Woes Expected to Linger, BUS. INS., Aug. 29, 1994, at 79.

\(^{140}\) See CHATSET GUIDE TO SYNDICATE RUN-OFFS 1993, 4 (John Rew & Charles Sturge eds. 1993).

The issue of inadequate reserving in respect of run-off liabilities will continue to plague Lloyd's Names. There is still an unquantifiable degree of under-reserving against long-tail liabilities incurred before 1986. Management at those syndicates most affected by potential under-reserving will have to make further cash calls on their Names, and the legitimacy of such calls will have to be decided by the courts if the worst-affected Names continue to protest.

MOODY'S, supra note 82, at 2. Little relief can be expected from these long-tail liabilities in the near term: "Our expected scenario projects future required reserve additions for the industry's [U.S.] environmental and asbestos exposures totaling $260 billion, spread over 15 years for asbestos claims and 25 years for environmental claims. This scenario has a net present value of $132 billion . . . ." See A.M. BEST CO. ENVIRONMENTAL/ ASBESTOS LIABILITY EXPOSURES: A P/C INDUSTRY BLACK HOLE, MAR. 28, 1994, at 6-7.

\(^{141}\) CHATSET LTD. LLOYD'S LEAGUE TABLES FOR 1991 2 (JUNE 1994).

\(^{142}\) Id. at 7.

\(^{143}\) Id. In December 1994, Chatset issued a report in which it increased its estimate of under-reserved business to £10.2 billion as of the end of 1993. See Janet Porter, Report: Lloyd's Reserves Fall Far Short of Future Claims, J. COM., Dec. 14, 1994, at 11A.

\(^{144}\) Randolph M. Fields, Lloyd's of London: The Adequacy of Financial
Predictably, these losses, and fears of greater losses, have led to a sharp reduction in the number of Names and syndicates underwriting actively at Lloyd's.  

In order to counter the decrease in capacity and inject new confidence in the marketplace, the leadership of Lloyd's announced the first ever business plan for Lloyd's. Its centerpiece was the inclusion of corporate capital as Names for the first time in the history of Lloyd's. In order to attract corporate capital, however, it was necessary to find a means to wall off or "ring fence" corporate capital from the losses emerging from "old years" (i.e., prior to 1985).  

A critical part of the operation is a new reinsurance company, Equitas. This new reinsurer would assume the liabilities of all Names for years prior to 1986. Syndicates will be required to reserve relevant liabilities on a uniform basis. Names will be asked to fund any shortfall in reserves on a gross basis and then reserves will be discounted to create a surplus. Equitas will be licensed and regulated by the Department of Trade and Industry.


In an October 1993 report, Moody's stated that the number of Names was 19,496, down from 32,433 in 1988. See MOODY'S, supra note 82, at 5. Active syndicates have dropped from 400 in 1989 to 178 in 1994. See Fiona Gibson, Lloyd's Record £2.05 Billion Market Loss For 1991, LLOYD'S LIST, May 18, 1994, at 1. For 1994, Lloyd's had 17,624 individual Names and 95 corporate Names. See Stacy Shapiro, Lloyd's Hopes to Put the Past Behind it and Return to Profitability, BUS. INS., Aug. 29, 1994, at 3.

See generally CORPORATE MEMBERSHIP, supra note 88, at 32-37.

Equitas was originally dubbed "NewCo." See supra note 78 and accompanying text.

"The business plan stated that NewCo. would discount reserves to generate its capital. However, time and distance covers may already have taken substantial benefit from the time value of loss payments into account." See Heidi E. Hutter, NewCo.-A Way Forward, THE SON, Apr. 1994, at 6.

See id. See generally BUSINESS PLAN, supra note 74, at 17-23. Cf. Howard, Lloyd's Struggles, supra note 79, at 3 (discussing the establishment of NewCo). Howard has noted:

The NewCo project will be developing structured payment plans so that Names will have a period of time to satisfy their obligations to NewCo. Since the liabilities are long-tail, she said that NewCo. won't need all the money in place on the first day of operations (which is planned for Jan. 1, 1996). . . . 'We don't want to bankrupt Names who intend to fulfill and discharge their obligations, but just can't do it in one big chunk.' Ms. [Heidi] Hutter[, director for the
Some believe that the Equitas proposal is an extremely ambitious undertaking.\textsuperscript{150} It involves thousands of syndicate years and a much greater number of debtors, dead and alive, solvent and insolvent. "The first step . . . [is] creation of a single database covering all known Lloyd's liabilities dating from 1985 and prior years which can be used to assist in the calculation of appropriate reserves for outstanding claims and claims 'incurred but not reported' (IBNRs)."\textsuperscript{151} This may prove a daunting task in itself.\textsuperscript{152}

A subsequent step is to set reserves based on "mandatory establishment of NewCo.] continued. Besides calculating reserves, the second major problem facing Ms. Hutter and her team is the capitalization of NewCo. The usual DTI guidelines are for capitalization and authorizations of live insurance companies that will actively write new business, she said. NewCo, she said, "is effectively a run-off company. No one has really said how much capital is needed to set up a run-off company.

\textit{Id.} There also are suggestions that Equitas should reinsure years subsequent to 1986 or that it should develop a "LiveCo" subsidiary to assume new risk. See Fiona Gibson, \textit{Lloyd's to Consider NewCo Cash Earner}, \textit{LLOYD'S LIST}, Jun. 7, 1994. Obviously, Lloyd's has not yet determined how to structure Equitas so that it will be acceptable to Names, creditors and the DTI.

\textsuperscript{150} Malcolm Mackenzie, Chairman of the Lloyd's Underwriting Agents Association, has observed that the Equitas effort is to "set up the largest reinsurance company in the world." Stacy Shapiro, \textit{Lloyd's Pinning its Hopes on NewCo}, BUS. INS., Aug. 29, 1994, at 24, 28. While this may be true with respect to liabilities, the issue is the ability to obtain assets which equal or exceed the liabilities.


\textsuperscript{152} David Springbett, 'Lloydsold': An Improved Solution for Lloyd's, \textit{LLOYD'S OF LONDON}, July 1993, at 6.

Lloyd's old records are in an appalling state and are often non-existent. Often underwriters kept no records whatsoever of what they had written, but merely relied upon the brokers honesty to close (pay) the risk. Brokers' archival records are often the only source of information and again these are sometimes non-existent, or impossible to find. Sometimes the only evidence of a contract is the policy itself, and that is in the hands of the claimants' lawyers!

To check the old files as is suggested in the [Lloyd's Business Plan] is equivalent to dreaming. There are millions of files involved and these are scattered over countless broking houses. \textit{Id.}
standards for reserving and . . . a common methodology." Standardizing innumerable reserving methodologies for thousands of syndicate years should prove to be a difficult technical task. Indeed, the Equitas project missed the end of 1994 timetable for sharing reserve projections with syndicates. However, the reallocation of liabilities that results would be the most controversial issue.

Names that are found to owe additional funds (to the extent they are solvent) are liable to resist bitterly additional payments for several reasons: (1) disagreement with the calculation; (2) inaccuracy of previous loss estimates;

153 BUSINESS PLAN, supra note 74, at 20.

154 "Because of poor past regulation, many syndicates have been able to manipulate their reserving according to the extent to which they were able to confuse their auditors." Id. at 6. Lloyd's has working parties approaching reserves from three different angles: (1) global trends; (2) projections from Lloyd's and London market statistics; and (3) extrapolation from experience of syndicates on pre-1986 business. Business Plan Progress Report, LLOYD'S (LLOYD'S OF LONDON, U.K.), May 1994, at 13.

Heidi Hutter, project director of the Equitas project estimates that "there are 550 syndicate 'lives' with liabilities pre-dating 1986 which will require [550] reinsurance quotations from NewCo." Howard, Lloyd's Struggles, supra note 79, at 3. This article does not define a "syndicate life" but presumably it is all years of a single syndicate on which there are open claims. The fact that Equitas will issue a quotation suggests that participation by syndicate will be optional, which means that Equitas will suffer from adverse selection (i.e., only the syndicates with the worst results will desire reinsurance). See id.

155 Project director Heidi Hutter stated, "[w]e did not want to come out with premature estimates of Lloyd's reserving requirements based on incomplete or unreconciled data. We did not want to produce one figure this December and then find six months later that we needed to revise it drastically." Equitas Project, LLOYD'S OF LONDON, Oct. 1994, at 2.

156 Mechanisms designed to protect the solvency of Names are breaking down: "Hundreds of Lloyd's names who prudently reinsured themselves against massive insurance losses have been told their claims are unlikely to be met in full . . . [B]ecause two insurance companies, Stockholm Re and Municipal General Insurance, which participated in the reinsurance of names' [personal stop-loss] policies have collapsed, obligations are not being met." Sarah Bagnall, Names Stop-Loss Warning, THE TIMES, Mar. 31, 1994, available in LEXIS, News Library, Curnws File.

157 A comparison of the Annual Report and Accounts for one syndicate, non-marine syndicate 528, is indicative. The 1987 Report characterizes the reinsurance to the close of the 1983 year after five years as "the closing of an unhappy chapter in the history of the Syndicate" as a result of its U.S. Liability Account. Unfortunately, the problem was not closed but merely moved to another chapter. The 1991 Report noted that the 1989 underwriting year would be left open due to the "wide range of estimated

https://scholarship.law.upenn.edu/jil/vol16/iss1/2
(3) belief they are being sheared like sheep;\textsuperscript{158} (4) blame of U.S. creditors and the U.S. legal system for losses far beyond those reasonably expected; (5) unwillingness to fund on a gross reserves to cover (U.S.) asbestos and pollution losses in respect of business written during 1986 and prior years. The great majority of the reserves relate to business written in 1983 and prior.” 1991 Annual Report, at 18.

Without a cap on liabilities, there is little reason for Names to believe their liabilities will not continue to escalate.

\textsuperscript{158} The reference is to a quote attributed to a senior Lloyd’s official: “If God had not meant them to be sheared, He would not have made them sheep.” Julian Barnes, \textit{The Deficit Millionaires}, \textit{New Yorker}, Sept. 20, 1993, at 92 [hereinafter Deficit Millionaires]. Some Names who have incurred crushing losses believe that they were lured into the marketplace to provide capacity for syndicates with heavy exposure to pollution and asbestos. One source has noted:

As investors delve into the reasons for their crushing losses, there is growing evidence that Lloyd’s insiders, the so-called working names—investors, brokers, agents and underwriters—had early warnings of the looming disaster, warnings they did not share with prospective investors. In hindsight, the 1980s are beginning to look increasingly like an era when Lloyd’s brought in new investors to take on hugely expensive risks from it more established names . . .

It was in asbestos, in particular, that long-established Lloyd’s names seem to have steered away from insurance lines that were peddled aggressively to newcomers. From 1984 to 1988, well after the first warnings from lawyers and accountants were received, market agents often ushered new investors directly into some of the riskiest of Lloyd’s more than 200 syndicates, correspondence and litigation indicates. The new names often could not get into the syndicates they desired, as these already were filled by established names, who make up about 20% of the current total of 18,000 names. And in many cases, the loss-ridden names claim, they were persuaded by Lloyd’s agents to join syndicates where the risks were never made clear.

Peter Truell, \textit{Mess at Lloyd’s May Have a Darker Side}, \textit{Wall St. J.}, Mar. 17, 1994, at A12. The alleged purpose for obtaining new Names and suppressing losses was not simply to spread losses but also to: (1) generate finders’ commissions; (2) generate illusory profit commissions for agents; and (3) increase the value of agencies for sale. \textit{Ultimate Risk}, \textit{supra} note 79, at 287-90.

For a well-written account of the plight of these Names, See \textit{Deficit Millionaires, supra}. With respect to the disastrous Gooda Walker syndicates: “A breakdown of all the Gooda Walker members for the years 1983 to 1989 (when the dangers of the L.M.X. spiral were being run) show that only ten percent were insider Names - half what you might expect if the market dealt fairly between the two segments and of its members. On Syndicate 387, a key location of financial horror, only three percent of the Names were insiders.” \textit{Id.} at 84. The result is litigation by 17,000 current and former Names against Names agents and managing agents. Parliament made Lloyd’s immune from suit in 1982, otherwise it too would be a defendant. \textit{Id.}
basis claims that are not yet due; and (6) fear that funds contributed will pay the debts of other names.

Moreover, Equitas, as a reinsurance facility, cannot negate the liability of Names to their creditors. As a result, the Names remain liable to creditors if Equitas becomes insolvent. There would seem to be little incentive for Names to pay their "fair share" to Equitas if they may be liable to pay this "fair share" a second time as a result of the insolvency of Equitas due to: (a) under reserving by Equitas; or (b) failure of other Names to pay their "fair share." It is not evident that Lloyd's can force Names to adopt the Equitas alternative\(^\text{159}\) or can extinguish the liabilities of Names to creditors. The Chairman of Lloyd's has confirmed to Parliament that the failure to collect sufficient assets to Equitas could seriously impact capital markets.\(^\text{160}\) It remains to be seen what incentives Lloyd's will be able to offer Names to buy into Equitas.

Even Lloyd's admits "[t]he Newco proposals are still at an early stage of development and there can be no certainty that they will prove viable."\(^\text{161}\) Some underwriters are declining to close years because they doubt the wherewithal of Equitas

\(^{159}\) While Lloyd's may find a Name no longer "fit and proper" to act as a Name at Lloyd's, many Names may have no interest in continuing as a Name and may, in fact, wish that Lloyd's had made such a finding many years earlier. See the comments of Heidi Hutter, project director of Equitas: "Ultimately, reinsurance into NewCo will be a mandatory exercise for the entire Lloyd's market. That's the way we can achieve the structural advantages of centralization which we expect to spring from the company." Lloyd's Faces Challenge of Open Years, INS. BROKER, Oct./Nov. 1994, at 52.

\(^{160}\) David Rowland, Chairman of Lloyds, testified before a select committee of the House of Commons in February of 1995:

The bad news is that the Names will be charged, later this year, a premium to off-load their liabilities into Equitas, and that premium could be very high . . . .

Conservative MP Quentin Davies asked: 'If Equitas fixes its premiums at such a level and the new cash calls are resisted, could that not precipitate the collapse of Lloyd's?'

Mr. Rowland replied: 'You're right. We depend on collecting from the Names. If Lloyd's has to call up money it cannot obtain, clearly that will affect its ongoing trading.'

Clare Sambrook, Lloyd's Future is New the All-Risks Question, DAILY TELEGRAPH, Feb. 11, 1995, at B2, B3.

\(^{161}\) Corporate Membership, supra note 107, at 32.
to meet its obligations.\textsuperscript{162} One analyst believes that the Equitas ring fence will cost between £4 and £6 billion and that Names on the old years could only pay a fraction of this amount in a lump sum.\textsuperscript{163} Given the prospect of being called upon to pay additional losses, financially beleaguered Names are reacting in predictable fashion. Christopher Stockwell, Chair of the Lloyd’s Names Association’s Working Party, stated, “[w]e’re not paying because there ain’t no more money.”\textsuperscript{164} There is open discussion among Names of hiding assets from Lloyd’s and other creditors.\textsuperscript{165} Lloyd’s is reacting by expanding its

\textsuperscript{162} Robert Terman, \textit{Murray upset for Lloyd’s}, SUNDAY TELEGRAPH, Mar. 27, 1994, available in LEXIS, News Library, Curnws File. One of Lloyd’s of London’s most respected figures has set the cat among Lime Street’s pigeons by refusing to close the 1991 underwriting account for the £115 million Syndicate 510. By leaving it open, Colin Murray, who heads the Kiln insurance agency and was once tipped to chair Lloyd’s, has presented a challenge to market chairman David Rowland’s plan to defuse the time bomb of past policies. . . . Murray’s decision casts doubt on whether underwriting groups can honestly close their books. . . . But Murray, whose Names have enjoyed a near-40 per cent underwriting profit, refuses to close because he cannot see how Newco can settle the 550 or more contracts it is likely to be offered. Assessing the claims risk for past years, he sees ’a big profit’ for 1993. “I cannot distribute profits unless I close,” he said. “But I cannot close if we are later going to have to go back to Names.” Insurers fear that the reason given by Murray for keeping Syndicate 510 open—that the risk on past long tail cover assembled under Newco is too great—applies to most other syndicates. If no syndicate need close, it makes a nonsense of the Lloyd’s system. Murray insists that closing the syndicate’s accounts would have been unfair—and, more importantly, would have left new joiners with potential liabilities for the past years.

\textsuperscript{163} See 1990 \textit{Lloyd’s: League Tables}, Chatset Ltd., Sept. 1993, at ii. “Clearly NewCo cannot call Names for more than 10% to 30% in one lump sum and hope to get paid by more than a minority.” MARKET SYNDICATE MANAGEMENT CHATSET GUIDE TO SYNDICATE RUN-OFFS 1993 4 (Nov. 1993).

\textsuperscript{164} Howard, \textit{Names Balk}, supra note 78, at 27. Mr. Stockwell went on to blame losses from the United States and the U.S. legal system for the problem. The Society of Names has observed, “Lloyd’s must be made to face a total non-payment by Names, and be forced to direct its fire at the holders of policies which should never have been sold. All old policies must be allowed to erode to the extent that the Names who underwrote them are insolvent or dead.” \textit{I Have No Gun But I Can Spit}, THE SON (Soc’y of Names, Adstock, Buckingham, U.K.), Apr. 1994, at 1.

\textsuperscript{165} Lloyd’s \textit{Sets out on Mission Impossible}, DAILY TELEGRAPH, Mar. 12, 1994 notes: ‘In members’ circles there is talk of distancing assets, setting
debt collection capabilities.  

Names have been further angered by Lloyd's attempt to appropriate the recoveries of delinquent Names against negligent Names' agents and underwriting agents. In turn, U.K. Names have asserted a number of defenses to actions by Lloyd's to reimburse the Central Fund for claims paid on behalf of delinquent Names. It appears that these defenses are having some success in offsetting or at least

up offshore trusts, giving homes away to children, buying properties abroad.” One said: “As you can imagine, quite a lot will put their money where Lloyd’s can't get it.” Id. Michael Denny, a leader of Names on the Gooda Walker syndicate commented: “There is no point in pursuing people who can't pay and the ones who won't pay have had two years to distance their assets. And Lloyd’s can't tell who could pay and is worth pursuing. Defaulting Names owing £375 million live outside the U.K. and collection actions against them can be problematic for Lloyd’s. A number of debtors are thought to have moved to debtor sanctuaries.

Lloyd's is poised to hire several debt collection specialists to recover outstanding debts from thousands of Names. Andrew Jack, Lloyd’s Set to Hire Debt Collectors to Chase Names, FIN. TIMES, Aug. 5, 1994, at 1. The balances are estimated at £2 billion. Shapiro, supra note 137, at 4. There is an estimated £1.3 billion due from 14,000 Names who have ceased underwriting and have withdrawn from the marketplace. Lisa Buckingham, Lloyd's Decides to Get Tough, THE GUARDIAN, Sept. 16, 1994, at 15.

Lloyd’s has proposed changes to the Premium Trust Deeds that would require that any recovery by a Name against a negligent Names’ agent or underwriting agent be paid into premium trust from which Lloyd’s can withdraw funds to pay overdue losses from Names. According to an October 20, 1994 letter to Names from David Rowland, Chairman of Lloyd’s the effect of the change:

[Would be to require the proceeds of litigation or settlement (relating to any year of account) to be used to pay liabilities outstanding at the time of receipt in respect of drawdowns from the Central Fund for 1987 and subsequent years of account; and/or

A. cash calls and closed year losses for these years of account.

Letter from David Rowland, Chairman of Lloyd’s, to Unspecified Names (Oct. 20 1994). “Lloyd's sources confirmed the move was prompted by the Department of Trade and Industry and the Bank of England. They are concerned that the Lloyd’s Central Fund, designed to protect policyholders in the event of nonpayment of claims by Names, is running dangerously low.” William Gleeson; Lloyd’s says rules change is crucial, INDEPENDENT, Oct. 21, 1994, available in LEXIS, News Library, Curnws File. Some Names, as well as other creditors of these Names, criticized this proposal as seeking an unfair preferential creditor status. Nonetheless, the Department of Trade and Industry approved such a change to the Premium Trust Deed. It is expected, however, that the Names will challenge this action in the courts. Helen MacLeod, Legality of Lloyd’s Move on funds Remain Uncertain, J.COM., Mar. 6, 1995, at 7A. https://scholarship.law.upenn.edu/jil/vol16/iss1/2
delaying reimbursement by Names.\textsuperscript{168} Five hundred sixteen U.S. Names are seeking the assistance of the U.S. courts in avoiding $3 billion in losses.\textsuperscript{169} The case law arising out of these U.S. efforts is provocative but inconclusive to date.\textsuperscript{170}

168 Lloyd's v. Clementson and Mason, Supreme Court of Judicature, Court of Appeal, Nov. 1994. The defendants asserted various defenses to collection actions which were dismissed as a matter of law by the lower court. The Court of Appeal reversed on two defenses, namely that Lloyd's may have violated European Community competition laws by use of the Central Fund to offset poor underwriting and by discrimination in accounting rules between reinsurance ceded by syndicates to other syndicates rather than to other reinsurers. Lloyd's has decided not to appeal. Toby Shelley, \textit{Lloyd's Halts Petitioning of Lords on Fund}, \textit{LLOYD'S LIST}, Dec. 2, 1994, at 1. Whatever the ultimate result, it will take several years to reach a final conclusion on the merits. In the interim, these defenses will be used by Names to avoid reimbursing the Central Fund which, in turn, will put increased pressure on various of Lloyd's security devices.

169 The forum-selection clause signed by Names requires actions to be brought in the United Kingdom, which is viewed as more sympathetic to Lloyd's than the United States. Nonetheless, U.S. Names are arguing that they were fraudulently induced to sign these contracts. John Jennings, \textit{Americans Sue Lloyd's in U.S. Court}, \textit{NAT'L UNDERWRITER}, Aug. 29, 1994, at 1. Twenty-six U.S. Names are suing Lloyd's U.S. counsel alleging that the firm knew of outstanding long-tail losses and that failure to disclose these losses was a breach of fiduciary duty, negligent misrepresentation and legal malpractice. Gavin Souter, \textit{U.S. Names Still Pressing For Home Court Advantage}, \textit{BUS. INS.}, Aug. 29, 1994, at 20, 24. Canadian Names are litigating to resist reimbursing banks that issued letters of credit which have been drawn down to pay claims. Brian Cox, \textit{Canadian Names Contest Claims By Lloyd's, Banks}, \textit{NAT'L UNDERWRITER}, Oct. 24, 1994, at 43. “Sarah Gibb, a committee member of the Gooda Walker action group . . . [has commented], ‘[t]he English Names will go into uproar if the Americans have a more attractive scheme.’” \textit{Id}. Clare Sambrook, \textit{Lloyd's to Approach American Names}, \textit{DAILY TELEGRAPH}, June 6, 1994, at 24.

170 Lloyd's Name Denied Injunction Against Draw on Lett or Credit, 5 MEALEY'S LITIGATION REPORTS, REINSURANCE No. 15, at 7, 7-8 (Dec. 7, 1994) (discussing Leslie v. Lloyd's, CA. NO. H-90-1907 (S.D. Tex. Nov. 7, 1994)). The court consolidated two actions. The first was brought by Leslie, a Name, for a preliminary injunction to prohibit Lloyd's from drawing down on Leslie's letter of credit in order to be reimbursed for losses paid on Leslie's behalf. The second was an action for monetary damages by Leslie against Lloyd's based on alleged breaches of deceptive trade practices laws, securities laws and of fiduciary duties. The findings of fact and conclusions of law in this case relate only to the preliminary injunction portion of the consolidated action. Among other things, the court found: (a) that Leslie had requested to be put on low risk syndicates but, in fact, was put on high risk syndicates; (b) that misrepresentations were made concerning the ability of a Name to limit losses by resigning; (c) that misrepresentations were made to the effect that unlimited liability was a technicality and that the possibility of serious losses was remote; (d) Lloyd's was aware, but did
Inability to collect losses from Names could precipitate a crisis for the Central Fund and, as a result, for Lloyd's ability to pass solvency tests.

The continuing poor results for 1991 are taking a toll on Names. Five thousand Names have defaulted on their obligations, 260 have been placed in bankruptcy and a number have committed suicide. Two thousand Names have applied for relief from the Members' Hardship Committee which is suggested as an alternative to bankruptcy. Names who are Members of Parliament and who become bankrupt must resign, which could impact on the Conservative Party's narrow majority.

Some observers suggest that there are limits on the willingness of Lloyd's to support Equitas:

Moody's detects a growing sentiment within Lloyd's

not inform Names, of serious under-reserving of losses for pollution and asbestos; (e) that Lloyd's embarked on a program of increasing its number of Names which had the effect of spreading losses from insiders to outsiders; and (f) that choice of laws and forum selection provisions were incorporated into Leslie's General Undertaking contract with Lloyd's when Lloyd's was aware of serious under-reserving for pollution and asbestos but Leslie was not. Ultimately, the court denied the preliminary injunction, however, on the bases that Leslie failed to prove irreparable injury for which monetary damages would be insufficient and failed to prove fraud which so vitiated the transaction as to deny Leslie any value from the transaction. It remains to be seen what influence the judge's findings of fact on the preliminary injunction action will have when that same judge considers Leslie's action for monetary damages. See id.

171 Roger Nuttall, Lloyd's Critic Bankrupted by £3 Million Losses, DAILY EXPRESS, July 6, 1994, at 3. The article states that Christopher Stockwell, chairman of the Names Association Working Party, "has claimed that more than 30 suicides have been linked with Lloyd's losses, although others dispute the figure, insisting that no more than eight deaths can be positively associated with losses by Names." Id.

172 Sarah Bagnall, Lloyd's Names Seek Charity, THE TIMES, July 8, 1994, at 2. The Hardship Committee is not a complete defense, however. Banks that guaranty the obligations of Names may still place a Name in bankruptcy. Diane Coyle, Key Lloyd's name Bankrupted; Leader of Investor' Group Blames Losses in Market After Bank Acts Over £2.86 Million Debt, THE INDEPENDENT, July 6, 1994, at 27.

173 Fifty-one Conservative Members of Parliament were reported by Labour MP Peter Hain to owe more than £22 million to Lloyd's. "But Mr. Hain claims that MPs have not been forced to stump up the cash because some would be bankrupted, forcing them to quit their seats and wiping out Mr. Major's slender majority." Scandal of the Tory MPs who Owe £22 Million, THE PEOPLE, July 24, 1994, at 6.
that some liability claims and awards are becoming so large as to cease to be entirely reasonable. On the basis of such a rationalization, it seems conceivable that future management at the Council of Lloyd's may not feel obligated to support NewCo if it gets into difficulties due to an "unreasonable" level of liability claims from across the Atlantic. Indeed, there is already a strong inference in the idea of establishing NewCo as a limited liability insurer outside Lloyd's that the market wishes to signal to cedents (and through them to the American legal profession) that a clear and tangible ceiling is to be set to the sums that Lloyd's is prepared to lose in respect of old liability claims. They are effectively saying that they are unwilling to pay away much more than the substantial reserves, the future investment income, and the capital of the proposed NewCo.¹⁷⁴

This situation makes the several Lloyd's trusts in the United States critical to U.S. creditors. Initially, they may be the only source of recovery if "New Lloyd's" with corporate capital is successful in cutting losses on old years adrift.¹⁷⁵ This heightens the importance of the adequacy and accessibility of trust assets.

¹⁷⁴ MOODY'S, supra note 83, at 12. John Rew, co-editor of Chatset has noted that Lloyd's has liabilities "way beyond its assets." He has likened Lloyd's to a ship towing a barge named Equitas which contains the garbage from past years. "They'll let the rope out slowly until at last it's so long that no longer will many associate the barge with Lloyd's and then they'll cut the cord [and move for a commutation]." Lisa S. Howard, Lloyd's Seen Moving to Commutation, NAT'L UNDERWRITER, Nov. 8, 1993, at 1, 6. Another commentator has stated that the "introduction of corporate capital appeared to be a way of allowing Lloyd's to trade profitably into the future while quietly ditching those who had been ruined by its negligence and incompetence." ULTIMATE RISK, supra note 79, at 268.

¹⁷⁵ "However, a spokeswoman for Lloyd's in New York, who did not wish to be named, pointed out that the largest of these liabilities, for instance, asbestosis, originated in the United States. In any case, it was unlikely Lloyd's would try to repatriate the money held in the Lloyd's American Trust Fund, although in theory it could, she said." Helen MacLeod, Some Policyholders Fear US Claims Won't Be Paid, J.COM., Dec. 14, 1994, at 11A. An official with the New York Insurance Department has commented: "I can tell you that with respect to the U.S. trust funds, we as regulators will not let the money leave this country." Stacy Shapiro, U.S. Settling of Lloyd's, BUS. INS., Dec. 12, 1994 at 10.
These trusts may be the only realistic source of funds for Equitas. In order to properly capitalize Equitas, it may be necessary to remove assets from the U.S. trusts and contribute them to Equitas in London where these assets can support worldwide losses. Such a result clearly would violate U.S.-Credit for Reinsurance laws and destroy the collateralization devices contained in such laws.

3. CURRENT DEVELOPMENTS IN THE LAW

Charges to the NAIC Reinsurance Task Force for 1993 included an examination of the devices used to collateralize the obligations of unlicensed reinsurers under the Model Act. During the course of 1993, the NAIC considered many of the issues described above. The Reinsurance Association of America ("RAA") advocated a number of changes to the Model Act with respect to collateralization devices. The most significant of these changes would have required that the LAT be a joint trust and that it be exclusively for the benefit of U.S. ceding insurers.

The RAA argued that a joint fund would provide a better use of the same assets and would ameliorate the dangers to creditors of a several fund. The rationale for exclusivity was that there should be one trust for surplus lines and a separate one for reinsurance. Commingling these collateralization devices can make it difficult to determine whether the trust has sufficient assets for all classes of creditors.

Little progress was made on this issue in 1993 and it was held over into 1994. In February of that year, the Reinsurance Working Group rejected the "joint" proposal. Later in that year, however, the Working Group adopted the "exclusivity" position, drafted investment guidelines for trust assets and defined liabilities to be collateralized to include losses which have been incurred but have not been reported to insurers. The Working Group has rejected the argument

177 See supra Section 2.2.1 (b)(iii).
that trust assets should be net of reinsurance recoverable. It remains to be seen whether these reforms will become part of the Model Act and Model Regulation and whether they will become law in a significant number of states.

While the Working Group has not adopted the most significant reform, a joint trust, the reforms which have been proposed are material improvements. In addition scrutiny of this area is likely to continue for some time. Issues often take years to develop at the NAIC and they are often influenced by outside events such as insolvencies, Congressional investigations and public identification of problem areas. A number of states are concerned about collateralization issues and have taken or are considering taking individual action on point.

3.1. The Trump Card: §304 of the Federal Bankruptcy Code

As noted in prior sections, unlicensed insurers are required to post collateral in order to write insurance in the United States and unlicensed reinsurers are required to post collateral in order for ceding companies to take credit for this reinsurance, either as an asset or a deduction from liability. The purpose of collateral requirements is to protect U.S. creditors from defaults by unlicensed insurers and reinsurers, particularly as a result of insolvency. Unfortunately, the intervention of Federal Bankruptcy Code Section 304 can

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179 See supra Section 2.3(ii).


181 See Meg Fletcher, U.S. Regulators Step Up Oversight of Lloyd's, BUS. INS., Aug. 29, 1994, at 42 (reporting that Michigan has discontinued a special exception for Lloyd's and is requiring additional collateralization for ceding companies heavily dependent on reinsurance from Lloyd's); New York is considering requiring more detailed financial information and is examining the LAT; Louisiana has called for a white list process for alien insurers and reinsurers and the NAIC is studying this proposal. Id.

182 11 U.S.C. §304 (1988). This section reads as follows:

(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.

(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court
completely undermine the protections contemplated by these collateralization requirements.

Section 109 of the Bankruptcy Code excludes from coverage domestic insurance companies and foreign insurance companies which are doing business in the United States. An ancillary proceeding, however, can be instituted with respect to a foreign insurer which is not doing business in the United States but has assets there.¹⁸³ This would include unlicensed insurers and reinsurers which assume U.S. business but have no offices or employees in the United States.

The purpose of Section 304, as stated in the statutory language and as noted in the cases cited below, is to protect the assets of a foreign bankrupt from claims in multiple proceedings in various nations and to recognize comity with respect to foreign bankruptcy courts. The effect of Section 304 is to allow bankruptcy judges to enjoin U.S. creditors from enforcing their rights under collateral trust agreements, turn over trust assets to foreign bankruptcy courts and force U.S.

(1) enjoin the commencement or continuation of -
   (A) any action against -
      (i) a debtor with respect to property involved in such foreign proceeding; or
      (ii) such property; or
   (B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
   (2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
   (3) order other appropriate relief.

(b) In determining whether to grant relief under subsection (c) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with -
   (1) just treatment of all holders of claims against or interests in such estate;
   (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
   (3) prevention of preferential or fraudulent dispositions of property of such estate;
   (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
   (5) comity; and
   (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.


https://scholarship.law.upenn.edu/jil/vol16/iss1/2
creditors to pursue their claims in a foreign nation.184

Section 304 petitions are being used in a number of current foreign receiverships185 and case law is still evolving. One observer has noted that "the perceived wisdom, at least in the UK, is that protection through section 304 should be sought at an early stage of an insolvency proceeding concerning a foreign insurance company which has significant creditors and assets in the U.S. and which is involved in litigation in the U.S."186 A few examples demonstrate the ability of Section 304 to seriously undermine the efficacy of insurance and reinsurance collateralization laws.

In Re Lines187 involved the River Plate Reinsurance Company which was domiciled in Bermuda and which had established a trust in New York to serve "as security for its American insureds and reinsureds whose claims may be payable in currency of the United States of America . . . ."188 The trust was similar to the LAT in that it required a claimant to file a certified judgment with the trustee and wait for thirty days before the claim was perfected.

A U.S. creditor filed a certified judgment with the trust on September 2, 1987 and two days later a receivership petition was filed in Bermuda. The court ruled that the creditor's interest had not been perfected, due to the thirty-day waiting period, and that creditors must pursue their rights through the Bermudian-court.

A more recent case, In Re Rubin,189 involved the receiver of Integrity Insurance Company ("Integrity") who was seeking to enforce a judgment against Israel Reinsurance Company Ltd. ("Israel Reinsurance"), domiciled in Israel. The trust agreement at issue was similar to the LAT and the trust found

186 Enoch & Nicholas, London, supra note 185, at 96.
188 Id. at 268-69 (quoting the trust agreement).
in the case *In Re Lines* in that a creditor must file a certified claim and wait thirty days before a claim is perfected. Since Integrity had not completed the necessary steps to perfect its claim, the court followed *In Re Lines*. Pursuant to the petition of Israel Reinsurance, the funds remained in trust in the United States. The court ordered a pro-rata distribution to creditors once the validity of claims had been determined by the bankruptcy court in Israel.

Although Bankruptcy Courts seem to favor section 304 petitions by foreign insurers,\(^1^\) this process has negative implications for the efficacy of current collateralization devices for unlicensed insurers and reinsurers. It is not evident at this stage that tinkering with the collateralization devices themselves will provide a sufficient answer. Perhaps the best answer is to exclude from section 304 collateral which is posted pursuant to insurance laws.

4. CONCLUSION

There are significant gaps in the protection offered to U.S. ceding companies by collateralization devices required by state insurance law for unlicensed reinsurers. These gaps are dangerous to the public because they can imperil the solvency of ceding companies. The NAIC is seeking to improve credit for reinsurance laws, but problems remain with the impediments to creditors contained both in the law and in trust documents.

U.S. creditors of foreign reinsurers would be benefitted substantially if regulators enforced current law on multiple creditor collateralization devices. Credit for reinsurance laws

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London Company insolvencies present substantial challenges to U.S. policyholders and other creditors. To date, creditors have met with little success in obtaining relief (via the courts or via stipulation) from section 304 orders in the United States. The courts have exhibited a tendency to defer to foreign bankruptcy proceedings, particularly those under English law, unless there is some fundamental unfairness to a certain type of creditor or need for a resolution of an issue under U.S. law. For that reason, the U.S. proceedings are expected to result in a turnover of U.S. assets to the provisional liquidators and in the centralized administration of those assets in the English insolvency proceedings.
could be improved by: (1) eliminating section 1(D) of the Model Act; (2) making the multiple creditor trust joint and exclusively for the benefit of U.S. creditors; or (3) making the collateralization devices described in section 1(D) more similar to section 2 collateral devices. In addition, regulators must scrutinize trust documents more closely to determine compliance with the spirit and letter of the insurance laws. Finally, creditors and insurance regulators alike should seek to amend the Bankruptcy Code to prevent section 304 from undercutting the essential purpose of state laws requiring collateral by unlicensed insurers and reinsurers.

\[191\] Model Act, supra note 6, §§ 1(D), 2.
APPENDIX A

LLOYD’S AMERICAN TRUST

WHEREAS:

1. THIS INSTRUMENT (hereinafter called “the American Trust Deed”) sets forth certain of the terms and provisions governing the American business of each Underwriting Member of the Society of Lloyd’s (hereinafter called “the Name”).

2. The parties under the American Trust Deed shall be the Name, the Agent through which the Name underwrites (hereinafter called “the Agent”), the Trustee hereunder acting from time to time (hereinafter called “the American Trustee”) and the Society of Lloyd’s (hereinafter called “Lloyd’s”).

3. The form of the American Trust Deed was originally adopted on August 26, 1939 and has heretofore been amended by various instruments dated October 31, 1947, January 14, 1948, October 2, 1963 and September 22, 1982, all such amendments being made by the Committee, the then governing body of Lloyd’s at the request of the Agent in accordance with Clause 17 of the American Trust Deed as heretofore amended.

4. The Agent has requested the Council, the present governing body of Lloyd’s, to exercise its power to vary and modify the trusts and provisions of the American Trust Deed in the manner set forth herein and the Council hereby exercises its said power by special resolution dated 5th April, 1989. The American Trustee has consented to the Council’s exercise of its said power. The American Trust Deed as so varied and modified shall constitute the American Instrument
and shall also constitute an Overseas Direction of the Council as those terms are defined in the Lloyd's Premiums Trust Deed approved by one of Her Britannic Majesty's Principal Secretaries of State under the Insurance Companies Act 1982 for insurance business other than long term business (hereinafter call "the Lloyd's Premiums Trust Deed").

5. The American Trust Deed as so varied and modified is hereby restated in its entirety.

NOW, THEREFORE, it has been agreed that the property held or hereafter received by the American Trustee shall be subject to the following trusts and provisions:

FIRST:  (A) The Name is an Underwriting Member of Lloyd's and underwrites through the agency of the Agent in association which certain other Underwriting Members of Lloyd's (hereinafter called "the other Names").

(B) The American Trust Deed shall relate and apply to the American business carried on by the Name and not to any other underwriting business which the Name may now or hereafter carry on at Lloyd's or elsewhere.

(C) "The American business" means such part of the Name's underwriting business at Lloyd's (other than long term business as defined from time to time by the Insurance Companies Act 1982 or by a later similar statute) as complies with the following two conditions: (i) the liability of the Name in respect thereof is expressed in U.S. dollars; and (ii) the premium payable to or for the account of the Name has been paid or is payable in U.S. dollars.

(D) Any reference in the American Trust Deed to "the American Trust Fund" means the property held in trust hereunder.

(E) Any reference in the American Trust Deed to "the Council" means the Council of Lloyd's constituted by Lloyd's Act 1982 and such of the following as shall from time
to time be authorized by the Council to exercise any power hereby conferred on the Council; the Committee on Lloyd's the Chairman of the Committee or a Deputy Chairman of the Committee, as the case may be.

(F) Any reference in the American Trust Deed to "the Premiums Trust Fund" means the property held in trust subject to the provisions of the Lloyd's Premiums Trust Deed.

(G) (i) Any reference in the American Trust Deed to "the Agent" means the Name's members agent at Lloyd's and any agent appointed by the members agent in exercise of any authority given by the Name (or appointed by any agent or sub-agent of the members agent acting under any such authority or delegation of such authority) to act as an agent or sub-agent of the Name for the purpose of conducting all of any part of the Name's underwriting business any successor thereto so acting and any Representative designated as hereinafter in this subdivision (G) provided.

(ii) The Agent may at any time and from time to time, by one or more instruments in writing filed which the American Trustee, designate any one or more employees of the Society (without limitation as to number) as the Agent's Representative or Representatives, and such Representative or any of such Representatives may, to the extent set forth in the relevant designation, act in like manner and with the same effect as the Agent itself might act hereunder. The designation of any employee of the Society as the Agent's Representative as hereinbefore provided shall remain effective unless and until revoked by the Agent by an instrument in writing filed with the American Trustee.

SECOND: The trusts hereunder shall subsist from the date of commencement of the underwriting business of the Name until such underwriting business shall have been wound up or until twenty-one years after the date of death of the Name, whichever shall first occur, which period shall be called "the trust term".
THIRD:  (A) Principal of the American Trust Fund shall consist of: (i) all premiums and other moneys payable during the trust term to or for the account of the Name in connection with the American business; (ii) all other assets from time to time transferred to the American Trustee to be held by it as part of the American Trust Fund; and (iii) all investments and moneys for the time being representing the same.

(B) (i) All premiums and other moneys payable to or for the account of the Name during the trust term in connection with the American business shall be paid or accounted for to the American Trustee and (by whomsoever and in whatever names the same may at any time be held) shall until so paid or accounted for be held on trust so to pay and account for the same, but the American Trustee need not inquire whether this provision has been complied with, or verify the correctness of any account submitted to it, or take any steps to collect the said premiums or other moneys, and the American Trustee shall only be responsible for the amounts actually received by it.

(ii) Because premiums may be received by the American Trustee before all brokerage and/or commission and/or discount payable in respect thereof has been paid, the Council may from time to time make regulations or give directions regarding the payment of such brokerage and/or commission and/or discount by the American Trustee. The American Trustee shall comply with such regulations and directions, and shall be protected in so doing, without inquiring whether or not the same are authorized or appropriate.

FOURTH: Income of the American Trust Fund shall be paid to the Premiums Trust Fund or transferred to principal of the American Trust Fund in such amounts as the Agent may from time to time direct. The American Trustee shall accept and act upon the statement of the Agent as to what income is to be paid or transferred in accordance with the foregoing provisions.
FIFTH: Principal of the American Trust Fund shall be held in trust for the following purposes:

(A) To pay any losses, claims, returns of premiums, re-insurance premiums and other outgoings in connection with the American business;

(B) To pay the expenses incurred in connection with the American business, which expenses shall be deemed to include: (i) remuneration and proper expenses of the American Trustee; (ii) any salary, commission, or other remuneration payable to the Agent or any other person, or any proper expenses of the Agent or any other person, in connection with the conduct or winding up of the American business; and (iii) a proper proportion as certified or reported by auditors approved by the Council of any salary, commission, or other remuneration payable to the Agent, or any proper expenses of the Agent, in connection with the conduct or winding up of any underwriting business of the Name, whether the American business or not, and any expenses whatsoever from time to time incurred in connection with any underwriting business of the Name, whether the American business or not;

(C) To transfer to the Premiums Trust Fund annually, if requested by the Agent, such property of the American Trust Fund as appears from certificates or reports given by auditors approved by the Council to be in excess of the amount or amounts required to be held in the American Trust Fund in accordance with the Instructions for the Guidance of Auditors issued by the Council from time to time in force to be held and dealt with as part of the Premiums Trust Fund.

(D) To transfer to the Premiums Trust Fund at any other time, if requested by the Agent and approved by the Council, such property of the American Trust Fund as is certified or reported by auditors approved by the Council to exceed the amount required to be held in the American Trust Fund for the purpose of providing for all liabilities both actual
and estimated in respect of the American business.

(E) The American Trustee shall accept and act upon the statement of the Agent as to what sums are from time to time required to be paid out of the American Trust Fund, and to whom payable, for any of the purposes specified in this Article without requiring the accuracy of any such statement to be verified, provided, however, that such statement shall be accompanied, where required by this Article, by a certificate or report of auditors approved by the Council and, where so required, by written evidence of Council approval; and provided further that such statement does not conflict with any regulation or direction of the Council to the American Trustee pursuant to Article THIRD (B) (ii) hereof.

(F) The American Trustee shall not be required to inquire as to: (i) the accuracy of any certificate or report of the said auditors furnished to it under the provisions of this Article; or (ii) whether such certificate or report has been prepared in accordance with the instructions and regulations of the Council; or (iii) the propriety of any approval by the Council. The American Trustee shall be fully protected in relying upon any auditors' certificate or report or any resolution of the Council determining what transfers may be made to the Premiums Trust Fund under the foregoing provisions of this Article.

(G) With respect to sums requested by the Agent to be paid in accordance with this Article, the American Trustee shall either make payment directly in the amounts and to the person or persons specified by the Agent, or, in its discretion, make payment to the Agent to be disbursed by the Agent in the manner specified. The American Trustee shall have no duty to see to the application of payments so made to the Agent, nor shall it be liable for the misapplication of such payments.

SIXTH: (A) The American Trust Fund shall inure for the benefit of all policy holders to whom the Name is liable in respect of the American business. No policy holder shall be
entitled at any time to charge the American Trustee in respect of any assets, other than the assets of the American Trust Fund in the hands of the American Trustee at the time the policy holder’s claim becomes enforceable as herein defined. Nor even after his claim becomes enforceable as herein defined, shall any policy holder be entitled to require from the American Trustee any account, or otherwise to inquire into the course of administration of the trusts relating to the American Trust Fund, or to question any act or thing done or suffered by the American Trustee, or otherwise to enforce such trusts, the sole right under the American Trust Deed of such policy holder being to receive the amount of his claim after it has become enforceable as herein defined from the assets of the American Trust fund then actually in the hands of the American Trustee and available for such payment as provided in subdivision (C) of this Article.

(B) The claim of a policy holder against the American Trust Fund shall become enforceable within the meaning of this Article when all of the following four conditions have been complied with:

(1) A judgment has been obtained by the policy holder in any court of competent jurisdiction Within the United States against the Name in respect of the Name’s liability under a policy.

(2) Such judgment has become final in the sense that the particular litigation has been concluded either through the failure to appeal within the time permitted therefor or through the final disposition of any appeal or appeals that may be taken. The word “appeal” as used in this subdivision (B) shall include any similar procedure for review permitted by the applicable law.

(3) The filing with the American Trustee of a certified copy of the said judgment, together with such proof as to its finality and its conformance with the other conditions specified in this subdivision (B) as the American Trustee shall require.
(4) The expiration of a period of thirty (30) days from the date of the filing of the said certified copy of the said judgment and all of the said proofs with the American Trustee without such judgment having been satisfied.

(C) Where the claim of any policy holder becomes enforceable as defined in subdivision (B) of this Article, the judgment therein referred to shall be forthwith satisfied by the American Trustee out of the American Trust Fund without regard to the rights of the other policy holders to whom the Name is liable in respect of the American business or any payment that may be then due for any of the purposes specified under Article FIFTH hereof, other than the remuneration and expenses of the American Trustee.

(D) The American Trustee shall be absolutely protected and shall incur no liability for any action taken or omitted by it in good faith hereunder, and shall be absolutely protected in relying upon the opinion of counsel in New York as to whether or not any judgment obtained by a policy holder conforms with all of the conditions specified in subdivision (B) of this Article, including, without limitation, whether or not the court in which such judgment was obtained is a court of competent jurisdiction within the meaning of the said subdivision, and whether or not such judgment is final within the meaning of the said subdivision. In the event of any suit or proceeding brought against the American Trustee based upon a judgment obtained by a policy holder against the Name in respect of the Name's liability under a policy, the American Trustee shall be entitled to charge against the American Trust Fund any expenses incurred by it in the said suit, including attorneys' fees, and also any judgment obtained against the American Trustee, including interest and costs.

SEVENTH:

(A) Subject to the aforesaid trusts, the American Trust Fund shall be held in trust during the trust term for the Name, his executors, administrators and assigns.
EIGHTH: (A) Subject to the requirements of the Council, the American Trust Fund shall be managed and invested by the American Trustee at the direction of the Agent.

(B) (i) The American Trustee shall not be bound to inquire whether the Agent has complied with the regulations and directions of the Council with respect to any investment and, unless otherwise directed by the Agent, shall be under no duty to take any action with respect to investments other than to collect the income or other sums payable thereon.

(ii) The American Trustee shall withdraw from the American Trust Fund such moneys or other property as the Agent directs for any of the purposes to which the American Trust Fund is applicable hereunder.

(iii) Unless the Agent otherwise directs, the American Trust Fund may be commingled with the American Trust Fund of any of the other Names.

(iv) The American Trustee shall notify the Agent of conversion or subscription or other rights accruing on property held in the American Trust fund and of any default in the payment of principal or interest or the passing of any dividend or other payment in respect of any such property. Such notice may be addressed to the Agent in care of Lloyd’s, London.

(v) As and when (but not otherwise) directed by the Agent in each particular case, the American Trustee shall exercise, sell or waive all conversion, subscription, voting and other rights of whatsoever nature including options and warrants, and grant proxies, discretionary or otherwise.

(vi) Unless the Agent otherwise directs, the American Trustee may register and hold property of the American Trust Fund in its own name or in the name of its nominee, or in an appropriate depository, without adding
words descriptive of its fiduciary character.

(C) The Agent may direct that all or any of the powers conferred on it by this Article of giving directions relating to the management and investment of the American Trust Fund shall be delegated to such company or other person (including any subsidiary, affiliate or associate of the American Trustee) on such terms and subject to such conditions, with such remuneration payable out of the American Trust Fund, as the Agent may think fit and agree with the company or other person to whom the delegation is to be made, and the Agent may at any time revoke or agree to vary any such delegation.

NINTH: Nothing herein contained shall constitute any partnership between the Name and the Agent or between the Name and any of the other Names, the underwriting business of the Name being carried on for this own sole and separate account.

TENTH: If any difference shall at any time arise between the American Trustee and the Name or his executors, administrators or assigns, or between the American Trustee and the Agent, relating to the Trusts under the American Trust Deed, or the administration thereof, or anything connected therewith, or if the American Trustee shall at any time feel any doubt or difficulty in administering the said trusts, it shall be an absolute protection to the American Trustee against all claims and demands whatsoever by the Name, his executors, administrators and assigns, or by the Agent, or by any other person (including any policy holder), that in case of any act or thing already done or omitted by the American Trustee the Council shall approve of such act or thing having been so done or omitted, and that in the case of any act or thing intended to be done or omitted the Council shall approve of such intended act or omission, and it shall not be necessary for the Council to give any reason for any such approval. The foregoing provisions of this Article are only for the protection of the American Trustee and shall not be construed to impose any obligation on the American Trustee to
apply for any such approval of the Council, nor shall the American Trustee be under any liability for omitting to do so.

ELEVENTH: The American Trustee shall submit to the Agent, whenever requested by the Agent in writing, an account in respect of its acts and proceedings as such trustee, but not oftener than semi-annually (except in the case of the death or retirement of the Name or in the event of the removal or resignation of the American Trustee). The approval of any account of the American Trustee by the Agent shall be binding and conclusive upon any and all persons interested hereunder, and shall constitute a complete discharge and acquittance to the American Trustee with respect to any and all matters covered by such account, and the American Trustee shall not thereafter be accountable to any person whomsoever with respect to its acts and proceedings during the period covered by such account. The American Trustee shall not be required to account to any person other than the Agent.

TWELFTH: The Council shall have power in its discretion to amend the American Trust Deed and also to revoke the trusts created hereunder; provided that such power shall not be exercised by the Council unless the Council is satisfied that all liabilities both actual and estimated of the Name in respect of the American business have been met or provided for and shall have so notified the American Trustee; and provided that any revocation of the trusts hereunder shall not be effective until five years (or any shorter period that may be permitted pursuant to the provisions of the New York State insurance law, or the regulations thereunder) from the date on which the Council shall notify the American Trustee in writing of the Council's intention to revoke such trusts; except that the foregoing provision shall not be deemed to prevent the replacement of the trusts hereunder with another trust or trusts meeting the requirements of the New York State insurance law, or the regulations thereunder; and provided that notice of the decision to replace the trusts shall be given to the American Trustee at least one year before such trust or trusts shall become effective. The Council shall give written notice to the American Trustee and to the Agent (and the
Agent shall in turn notify the Name) of any such amendment or revocation and of the effective date thereof. The American Trustee shall notify the Superintendent of Insurance of the State of New York within thirty (30) days of the American Trustee’s receipt of notification that the American Trust Deed has been amended or the trusts created hereunder have been revoked, or that such trusts will be replaced.

THIRTEENTH: The American Trustee shall accept written notice given by the Council as to the identity of the Agent. The American Trustee shall be protected in acting upon any written statement made by the Agent with respect to the authority conferred on it whether directly or indirectly by the Name.

FOURTEENTH: The Council may make such arrangements with the American Trustee as the Council and the American Trustee think fit as to the remuneration of the American Trustee and any such remuneration shall be an expense of the American Trust Fund. The American Trustee shall be entitled to reimbursement out of the American Trust Fund of any reasonable expenses (including, without limiting the Generality of the foregoing, counsel fees) incurred by it in connection with the administration of the American Trust Fund, and the American Trustee shall have a first lien on the property from time to time comprising the American Trust Fund for any such remuneration and the amount of any such expenses.

FIFTEENTH: Subject to the effective date provisions of this Article, the American Trustee may at any time be removed as trustee and a new American Trustee appointed hereunder by a resolution passed by the Council, provided that any trustee appointed under this Article shall be a bank or trust company organized under the laws of the United States of America or any State thereof and shall be a member of the Federal Reserve System in the United States of America. Upon adoption of any such resolution of appointment, an authorized officer of Lloyd’s shall execute such instruments as are necessary or proper for effectuating the appointment of the
new American trustee. Upon the appointment of the new American Trustee, the American Trust Fund shall be transferred to the new American Trustee. The American Trustee may resign at any time by giving written notice addressed to the Chairman of Lloyd's, London. Such removal or resignation shall take effect on the date specified therein, which shall not be less than ninety (90) days from the date of the Council’s resolution of removal or the date the resignation is mailed, as the case may be. On and after the effective date of such removal or resignation, the sole duty of the former American Trustee shall be to transfer the American Trust Fund to the new American Trustee. The former American Trustee shall, nevertheless, remain entitled to the settlement of its account and to the payment out of the American Trust Fund of any compensation due to it up to the time of its removal or resignation and any expenses or other disbursements (whether theretofore or thereafter arising) for which it would be entitled to reimbursement from the American Trust Fund if it had not been transferred to the new American Trustee.

SIXTEENTH:

(A) The American Trustee shall be protected in relying upon the authenticity of any communication from the Council which purports to be signed by an authorized officer of Lloyd’s.

(B) The American Trustee shall also be fully protected for any action taken or omitted by it in reliance on any written instrument of any kind believed by it to be genuine and purporting to be signed or sent by the proper person or persons or to have been passed by the proper authorities.

(C) The American Trustee may require that any request made by the Agent under this instrument shall be in writing and filed with the American Trustee at its head office.
SEVENTEENTH: The legal estate in property from time to time constituting the American Trust Fund shall be vested in the American Trustee, subject only to the execution of the trusts hereunder, and the only right of the Name, his executors, administrators and assigns shall be one in personam against the American Trustee to enforce the performance of the trusts hereunder, and pursuant thereto to receive any balance that may be available after the application of the American Trust Fund for all of the other purposes specified hereunder.

EIGHTEENTH: The provisions of the American Trust Deed and the rights of all parties in respect of the American Trust Fund shall be governed by the laws of the State of New York.