Introduction to Surplus Lines
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• Julia Van Buren, MarketScout
• Kay Miller, USI
• Joe Wurtz, All Risks
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Topics

• What is Surplus Lines Insurance?
• Surplus Lines Purpose and Function
• Advantages/Disadvantages of the Non-Admitted Market
• Types of Risks in the Surplus Lines Market
• Surplus Lines Insurance Products
• Surplus Lines Insurance Distribution
• Surplus Lines Licensing
  – A Few State Specific Licensing Information
  – Required Notifications
Topics (con’t)

• Surplus Lines Regulation and Legislation
  – Solvency Regulation
  – Broker Regulation
  – Legislative Changes
  – Home State Determination
  – Home State Determination Scenario #1
  – Home State Determination Scenario #2
  – Diligent Search
  – Diligent Search Exceptions
  – State Stamping & Disclosures
  – Stamping Offices & Surplus Lines Associations

• Surplus Lines Broker Responsibilities
• Surplus Lines Resources
• Question & Answer Session
Surplus Lines Insurance
What is it?
Surplus Lines Insurance
What is it?

• Not a LINE of business
• A MARKETPLACE for RISKS that standard (admitted) carriers cannot or will not insure

However, still includes many of the same coverages found the standard market:

- General Liability
- Property
- Excess & Umbrella
- Package Policies
- Builders Risk
- Directors & Officers
The MOST critical and fundamental tenet of Surplus Lines insurance is the freedom of rate and form regulation.
# Surplus Lines Insurance

## What makes it different?

<table>
<thead>
<tr>
<th>Admitted Insurers</th>
<th>Nonadmitted Insurers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulated in every state, overseeing:</td>
<td>Limited regulation:</td>
</tr>
<tr>
<td>• Rate &amp; Form filings</td>
<td>• Freedom of rate &amp; form filing</td>
</tr>
<tr>
<td>• Financial Solvency</td>
<td>• Financial Solvency only in insurer’s state of domicile</td>
</tr>
<tr>
<td>• Market Conduct</td>
<td>• No guaranty fund contribution or protection</td>
</tr>
<tr>
<td>• Contributes to AND is covered under state guaranty funds</td>
<td></td>
</tr>
</tbody>
</table>
Surplus Lines Insurance

Purpose and Function
Surplus Lines Purpose and Function within the Insurance Industry

The “safety valve” of the insurance industry

Surplus lines insurance fills the need for coverage in the marketplace by insuring those risks that are declined by the standard underwriting and pricing processes of admitted insurance carriers.
Surplus Lines Purpose and Function

The surplus lines market plays an important role in providing insurance for hard-to-place, unique or high capacity risks.

Surplus lines insurers are able to cover unique and hard-to-place risks because they are able to react to market changes and accommodate the unique needs of insureds that are unable to obtain coverage from admitted carriers.
The surplus lines market is particularly important in introducing new products to the market in an efficient manner.

New and innovative products for which there is no loss history are difficult, if not impossible, to price or rate for insurance purposes.
Advantages/Disadvantages of the Non-Admitted Market

**Advantages**
- Allows carriers to create unique/manuscript policies.
- Rates can be established on a case-by-case basis.

**Disadvantages**
- Surplus lines taxes and other relevant fees/costs.
- No protection from the state guaranty fund, if a carrier becomes insolvent.
- Lots of compliance (ex. Policy documentation compliance, affidavit compliance, filing compliance, payment compliance).
- The steep penalties that can result, if surplus lines filings and/or taxes not timely made.
Types of Risks in Surplus Lines Insurance
The majority of surplus lines business consists of commercial lines insurance,

Most risks placed in the surplus lines market can be classified as one of the following:

• Distressed risks
• Unique risks
• High-capacity risks
• New or emerging risks
Types of Risks in the Surplus Lines Market

Distressed Risks

Characterized by unfavorable attributes, such as a history of frequent losses or the potential for catastrophic losses that make them unacceptable to admitted insurers.

Examples of distressed risks include:

- A vacant building
- A shopping mall with frequent liability claims
- A manufacturer of explosives.
Types of Risks in the Surplus Lines Market

Unique Risks

Risks so specialized, unusual or complex that admitted insurers are unwilling or unprepared to insure them.

Examples of unique risks include:

- A music festival, concert, or motorcycle rally
- A medical device manufacturer for a new product in clinical trials.
- Satellite launches
Types of Risks in the Surplus Lines Market

High-Capacity Risks

Risks requiring high insurance limits that may exceed the capacity of the standard market.

Examples of high-capacity risks include:
- A museum with a $1 billion art collection
- A chemical plant or waste site
- A skyscraper
New or Emerging Risks

Risks requiring special underwriting expertise and flexibility that the surplus lines market can provide.

Examples of new and emerging risks include:
- Unmanned aircrafts & drones
- Medical and recreational marijuana
- Sharing economy
- Cyber bullying and violent acts in schools
Surplus Lines Products
Surplus Lines Insurance Products

The Surplus Lines market provides an array of insurance products for many different classes of business, including:

- General Liability
- Contractors Liability
- Inland Marine
- Aviation
- Fire and Allied Lines (Property)

- Multi Peril (Property & General Liability)
- Products and Completed Operations
- Professional Liability
- Liquor Liability
Surplus Lines Insurance Products

Examples of types of risks for General Liability often found in the surplus lines market:

- Asbestos Removal & Abatement
- Pollution & Contamination
- Firearms Liability/Gun-smithing
- Nursing and Group Homes
- Welding Operations
- Legal Brothels
- Mining
- Amusement Rides & Attractions
- Security Guards
Surplus Lines Insurance Products

Examples of types of risks for Contractors General Liability often found in the surplus lines market:

- Blasting
- Roofers
- Waterproofing
- Carpenters
- Excavation & Trenching
- Tree & Stump Removal Services
- Tank Maintenance & Removal
Surplus Lines Insurance Products

Examples of types of risks for Fire & Allied Lines (Property) often found in the surplus lines market:

- Bars, Taverns and Breweries
- Earthquake
- Churches
- Nuclear Power Plants
- Vacant Commercial Buildings
- Legal Brothels
- Marijuana production facilities
- Amusement Parks
Surplus Lines Insurance Products

Examples of types of risks for Professional Liability often found in the surplus lines market:

- Architects & Engineers
- Clinical Laboratories
- Healing/Alternative Medicine
- Waterproofing
- Psychologists & Counselors
- Environment Consultants
- Real Estate Appraisers
Surplus Lines Insurance Products

Examples of specialty & unique risks often found in the surplus lines market:

- Prize Indemnification (Hole-in-one)
- Event/Festival Coverage
- Weather Insurance
- Kidnap/Ransom
- Animal Mortality
- Legal Brothels
- Hand/Arm/Voice insurance for professional athletes or celebrities
Surplus Lines Insurance Products

Claims

There can be differences between working standard versus surplus lines claims:

- Multiple carriers may be covering a loss
- Policy complexities
- Agent/broker relationships
Surplus Lines Distribution
Retail agent, surplus lines intermediaries and insurers are the primary distributors for surplus lines insurance. They all play an important role in helping consumers find insurance coverage that is unavailable in the standard market:

- Retail Agents/Brokers
- Surplus lines intermediaries
- Surplus Lines Insurers
Surplus Lines Distribution

Surplus Lines Intermediaries

- Wholesale brokers
- Managing general agents (MGAs),
- Program Managers
Surplus Lines Specialty Insurer
Insurers specifically focused on surplus lines or specialty business.

Global Insurers with surplus lines affiliates
Global Insurance Organizations that have affiliates which specialize in surplus lines business, but whose overall business model is focused on admitted business

Lloyd’s Syndicates
Retail producers can be either agents that represent the insurer or brokers that represent the insured.
Surplus Lines Licensing
Surplus Lines Licensing

• Who needs to hold a surplus lines license?
• Agent and/or Agency
• Underlying Producer License needed for non-resident license?
• Any bond requirements for non-resident licenses?
• Any testing requirements for a non-resident?
• Fines associated with Licensing
Surplus Lines Licensing (con’t)

• Surplus Lines Association and/or Stamping Offices Membership
• Work closely with your accounting department or whoever makes the filings
A Few State Specific Licensing Information

• California
  – 2 hours surplus lines training course every 5 years
  – Special Lines’ Surplus Lines Broker license – no notice sent

• Florida – Self appointment a/k/a e-appoint; $150 every two years – no notice sent

• New Mexico – two affiliations of surplus lines licensees are required to file under the agency license

• Nevada – must notify SLA when surplus lines license is renewed
Required Notifications

• Address Changes
• Name Changes
• Administrative Actions
• IL – must notify the IL DOI producer licensing department, surplus lines producer department and SLA.
Surplus Lines Insurance Regulation & Legislation
The Surplus Lines Regulation & Legislation

Some state statutes refer to surplus lines market as the “unauthorized” or “unlicensed” market. This leads some to infer that the surplus lines market as unregulated.

(This is not true)

Every state has rules and regulations within its insurance code that are specifically written to govern surplus lines insurance.
Each surplus lines insurer is licensed in at least one of the 50 states and must fulfill the solvency requirements of that state or jurisdiction. Thus, the surplus lines insurer’s state of domicile becomes the financial solvency regulator of that insurer.
While solvency regulation is the purview of the surplus lines insurer’s domiciliary state, the actual surplus lines transaction is regulated through a licensed surplus lines broker. This broker is responsible for:

1. Selecting an eligible surplus lines insurer
2. Reporting the surplus lines transaction to regulators
3. Remitting the premium tax to state tax authorities
4. Assuring compliance with all the requirements of the surplus lines codes
The Surplus Lines Regulation & Legislation

Legislative Changes

- Nonadmitted and Reinsurance Reform Act (NRRA), Subtitle B, Part I, Dodd-Frank Wall Street Reform and Consumer Protection Act (Note: Went into effect on July 21, 2011)
  - Simplified surplus lines taxes and created uniformity.
  - The surplus lines broker only needs to be licensed in the insured’s Home State.
  - Only the insured’s Home State may tax and regulate placement of a surplus lines insurance policy.
  - Policies are filed in the insured’s Home State only.
  - For Affiliated Groups, the insured’s Home State is the state of the principal place of business of the member of the affiliated group that has the largest percentage of premium attributed to it.
The Surplus Lines Regulation & Legislation

Legislative Changes

Pre-Nonadmitted and Reinsurance Reform Act (NRRA)

Insured with Multistate Risk in 20 States

Surplus Lines Broker

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>20%</td>
</tr>
<tr>
<td>B</td>
<td>4%</td>
</tr>
<tr>
<td>C</td>
<td>5%</td>
</tr>
<tr>
<td>D</td>
<td>12%</td>
</tr>
<tr>
<td>E</td>
<td>5%</td>
</tr>
<tr>
<td>F</td>
<td>4.2%</td>
</tr>
<tr>
<td>G</td>
<td>0.8%</td>
</tr>
<tr>
<td>H</td>
<td>6.1%</td>
</tr>
<tr>
<td>I</td>
<td>3.3%</td>
</tr>
<tr>
<td>J</td>
<td>8.1%</td>
</tr>
<tr>
<td>K</td>
<td>7%</td>
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<tr>
<td>L</td>
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<td>M</td>
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</tr>
<tr>
<td>S</td>
<td>3.5%</td>
</tr>
<tr>
<td>R</td>
<td>2.7%</td>
</tr>
<tr>
<td>P</td>
<td>2%</td>
</tr>
<tr>
<td>O</td>
<td>3%</td>
</tr>
</tbody>
</table>

Surplus Lines Premium Tax

Multistate risk premium tax, allocated to each state with proportion of risk calculated using rules and allocation methodologies that were inconsistent in many states. Each state’s proportion of premium paid directly to each state by broker.

Post-NRRA

Insured with Multistate Risk In 20 States

Surplus Lines Broker

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>(Home State) 100%</td>
</tr>
</tbody>
</table>

Source: National Association of Professional Surplus Lines Offices, Ltd.
## Home State Determination

### Business:

1. What is the state of the insured’s principal place of business?

   The state of the insured’s “principal place of business” is the state where the insured is headquartered and conducts its main business operations. If the insured’s high-level officers direct, control and coordinate the business activities of the insured in more than one state, the principal place of business may be the state in which the greatest percentage of the insured’s taxable premium for the applicable insurance contract is allocated. Principal place of business may or may not be the state where the insured is domiciled or incorporated.

2. Is any portion of the premium allocable to the insured’s principal place of business state as defined above?

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
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<tbody>
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</tr>
</tbody>
</table>

   If yes, the Home State is the state of the insured’s principal place of business or principal residence.

   If no, The Home State is the state to which the largest percentage of premium is allocable.

   State: __________

### Individual:

If multiple non-resident family members are named on the policy, if one pays 100% of the policy premium for all insured’s, then answer the questions below based on their information. They will determine the Home State. If not, premiums must be allocated by determining the “Home State” of each non-resident insured purchaser:

1. What is the state of the insured’s principal residence?

   The state of the insured’s “principal residence” is the state in which the insured resides for the greatest number of days during a calendar year. If the insured resides outside the United States, the state of principal residence is the state to which the greatest percentage of the insured’s taxable premium for the applicable insurance contract is allocated.

2. Is any portion of the premium allocable to the insured’s principal residence state as defined above?

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
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<tbody>
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</tbody>
</table>

   If yes, the Home State is the state of the insured’s principal residence.

   If no, The Home State is the state to which the largest percentage of premium is allocable.

   State: __________
The Surplus Lines Regulation & Legislation
Home State Determination - SCENARIO #1

Which State is the Home State?

FACTS:

Mailing Address:
685 Producer Rowe, Tampa, FL 33637

Corporate Office:
125 Los Flores, Orlando, FL 32891

Risk Locations:
1. 333-335 Figueroa, Albuquerque, NM 87153
2. 491 Old Santa Fe Trail, Santa Fe, NM 87501
3. 325 Don Gaspar, Taos, NM 87501
4. 114 North Main St, Roswell, NM 88203
5. 125 Los Flores, Orlando, FL 32891 (Corporate office)
6. 685 Producer Rowe, Tampa, FL 33637

Answer: Florida is the home state because some risk will be insured in the state where the nerve center is located.
The Surplus Lines Regulation & Legislation
Home State Determination - SCENARIO #2

Which State is the Home State?

**FACTS:**

**Mailing Address:**
1234 Grand Avenue, Irvine, CA 92697

**Corporate Office:**
125 Los Flores, Orlando, FL 32891

**Risk Locations:**
1. 1234 Grand Avenue, Irvine, CA 92697
2. 654 Sycamore, Los Angeles, CA 90002
3. 333-335 Figueroa, Albuquerque, NM 87153
4. 700 North Main, Las Cruces, NM 88001
5. 325 Don Gaspar, Taos, NM 87501
6. 685 Producer Rowe, Tampa, FL 33637

**Answer:**

*Florida* is the home state because some risk will be insured in the state where the *nerve center* is located even though the Corporate Office (nerve center) is not included as an insured location.
The Surplus Lines Regulation & Legislation

Diligent Search

• Insurance laws generally require that a “diligent search” of the admitted market be performed before a risk can be exported to a surplus lines insurer. In general, the diligent search requirement requires up to three declinations from admitted insurers prior to placing coverage with a nonadmitted insurer.

• Most states require 3 declinations from the admitted market. However, OH requires 5 declinations and NM requires 4 declinations.

• There are 4 states that do NOT require a diligent search (LA, MS, VA & WI).
In certain states, some types of risks can be placed in the surplus lines market without the diligent search requirement.

- Many states have created an “export list,” which sets forth types of risks for which there is little or no coverage available in the state’s admitted market.

- Exempt Commercial Purchaser
  
  Under the NRRA, an exempt commercial purchaser is any person purchasing commercial insurance that, at the time of placement, meets the following requirements: (A) The person employs or retains a qualified risk manager (as defined in the NRRA) to negotiate insurance coverage; (B) The person has paid aggregate nationwide commercial property and casualty insurance premiums in excess of $100,000 in the immediately preceding twelve months; and (C) The person meets at least one of the five following criteria: (I) the person possesses a net worth in excess of $22,040,000, (II) the person generates annual revenues in excess of $55,100,000, (III) the person employs more than five hundred full-time or full-time equivalent employees per individual insured or is a member of an affiliated group employing more than 1,000 employees in the aggregate, (IV) the person is a not-for-profit organization or public entity generating annual budgeted expenditures of at least $33,060,000 or (V) the person is a municipality with a population in excess of fifty thousand persons.

- Industrial Insured Exemption;
  
  A number of states currently have exemptions for commercial purchasers (called “industrial insureds” in many states). Those exemptions are not preempted by the NRRA. Thus, in those states, if the industrial insured exemption is retained, there could be two classes of exemptions: one for entities that meet the NRRA exempt commercial purchaser requirements and one for entities that meet the state’s industrial insured exemption. Before taking advantage of the exemption, brokers should check the law of the home state of the insured as well as the NRRA definition to ensure that the exemption is used correctly.
The Surplus Lines Regulation & Legislation

State Stamping & Disclosures

Every state requires a notification to the insured party in a surplus lines transaction. In the form of state stamping language or cost disclosure forms, these notices usually disclose:

1. The surplus lines policy is not covered by the state guaranty fund and/or:

2. The insurance is placed with a surplus lines company that is not subject to many of the state’s regulations.
The Surplus Lines Regulation & Legislation

State Stamping & Disclosures

Stamping Language Examples:

**Nevada**

This insurance contract is issued pursuant to the Nevada insurance laws by an insurer neither licensed by nor under the supervision of the Division of Insurance of the Department of Business and Industry of the State of Nevada. If the insurer is found insolvent, a claim under this contract is not covered by the Nevada Insurance Guaranty Association Act.

**Michigan**

This insurance has been placed with an insurer that is not licensed by the state of Michigan. In case of insolvency, payment of claims may not be guaranteed.
The nature of surplus lines insurance has resulted in the creation of organizations that facilitate and encourage compliance with laws and regulations regarding surplus lines placements.

These organizations are called stamping offices, or surplus lines associations.
Surplus Lines Insurance
Broker Responsibilities
Surplus Lines licensees (both entities and individuals) have unique and varying state-specific responsibilities.

1. Confirming policy documentation and affidavits adhere to state regulations and requirements
2. Filing policies with each state
3. Filing and various state-specific surplus lines reports
4. Filing and paying surplus lines premium taxes and stamping fees
The task of policy filing depends on the state. Regardless of the filing platform or documentation required, the task of filing a policy means reporting basic surplus lines policy information to a state, stamping office or surplus lines association. This information usually includes some or all of the following:

- Name and address of the Insured
- Policy Number
- Effective dates
- Name of the non-admitted carrier
- Policy Premium, Taxes and Fees
- Type of coverage (Property, General Liability)
- Coverage limits
Surplus Lines Insurance
Broker Responsibilities

Policy Detail

Policy Details

Policy Number
Broker
Coverage Category
Coverage Code
Description of Coverage

Notes

■ Courtesy Filing  ■ Layered Risk
■ Multi-State  ■ Participating Policy
■ Master Policy  ■ Exempt Commercial Purchaser

Named Insured as Listed on Policy
Insured Address
Effective Date
Expiration Date
Location of Risk
Location of Risk Address Line 1
Location of Risk Address Line 2
City/Town
State/Province
ZIP/Postal Code
Country

Insurer/Percentage

Insurer
Percentage

TOTAL
0%

Add Insurer to Policy

Declination Detail

Admitted Insurer
Underwriter
Reason

Add Policy Transaction

Transaction Type
Premium
Taxable Fee
Effective Date
Expiration Date
Documents

Edit  Save  Cancel
Beyond SLIP, other states accept surplus lines policies through:

- Online filing platforms or websites that are created, maintained and utilized by an individual state, stamping office or surplus lines association. Examples of this include New York, Texas, Arizona and Utah.
- OPTins, where policy filings are completed with tax filings.
- Email or mail, where policy filing information is sent to a state, also usually done with tax filings.
Surplus Lines Resources
Surplus Lines Resources

• SILA (SILA.org)
  — a wealth of surplus lines information in the Best Practices handbook. Lots of quick reference charts, etc.

• NAIC.org
  — This link is useful to find states where a carrier is available for use. Once in website, click on “Consumers” link at the top. Then, under tools about half way down on the righthand side, click on the Consumer Information Source link.
  — www.naic.org

• NAIC State Insurance Department Web Sites
  — http://www.naic.org/state_web_map.htm

• NAIC Quarterly Listing of Alien Insurers
  — http://www.naic.org/prod_serv_fin_receivership.htm#quarterly_alien

• US Stamping Offices
  — https://www.wsia.org/wcm/Legislative_Advocacy___PAC/Stamping_Offices___SLAs/wcm/Legislative_Advocacy___PAC/Stamping_Offices___SLAs.aspx?hkey=e03891de-b12e-4a17-b91f-1a968c6d7943
Surplus Lines Resources (con’t)

• CIAB (Council of Insurance Agents and Brokers) PAID SUBSCRIPTION
  – https://www.ciab.com

• FC&S Licensing & Surplus Lines Laws – PAID SUBSCRIPTION
  – Paper publication and also available through Silverplume/Sage
  – http://www.nationalunderwriterpc.com/Pages/default.aspx

• Excess & Surplus Lines Manual
  – The national law firm of Locke Lord LLP publishes a reference book "Excess and Surplus Lines Laws in the United States" providing details on the E&S regulations of 53 US regulatory locations. As a service to the industry, the public is offered access to this document on-line at no cost. You must register once and then will need to remember your sign on (your email address) and your password.

• National Conference of Insurance Guaranty Funds
  – http://ncigf.org/
Surplus Lines Resources (con’t)

• **ODEN – PAID SUBSCRIPTION**
  – Resource providing summaries of certain compliance areas, such as Surplus Lines, including statutes, regulations, bulletins and other regulatory sources

• **Advisen – SOME OF THE INFORMATION IS FREE AND SOME OF IT IS A PAID SUBSCRIPTION.**

• **Surplus Line Associates, LLC – PAID SUBSCRIPTION**

• **National Conference of Insurance Legislatures**
  – [www.ncoil.org](http://www.ncoil.org)

• **WSIA (Wholesale & Specialty Insurance Association [formerly NAPSLO]**
  – [https://www.wsia.org/](https://www.wsia.org/)
Question & Answer Session