



**National Association of
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The Honorable Teresa D. Miller
Commissioner, Pennsylvania Insurance Department
Chair, NAIC Property and Casualty Insurance (C) Committee

Via Email: abrandenburg@naic.org

Dear Commissioner Miller and Members of the Property and Casualty Insurance (C) Committee:

On behalf of the National Association of Professional Surplus Lines Offices (NAPSLO), thank you for inviting us to provide our thoughts and comments to the Committee regarding the regulation of and consumer protections within the surplus lines market in light of the pending Flood Insurance Market Parity and Modernization Act (H.R. 2901). NAPSLO serves the \$40.2 billion surplus lines market, which NAPSLO members broker and underwrite a very high proportion of, and we strongly support H.R. 2901. We were thrilled when the bill passed the HFSC unanimously on March 2 and hope to see the House pass the legislation this week.

Aside from the very important provision that clarifies the ability of private insurers, both admitted and nonadmitted, to provide private market solutions and preserve consumer choice, H.R. 2901 also clarifies the state regulator's authority to regulate the transaction. NAPSLO strongly supports state insurance regulation and believes state insurance regulators have the experience and strong track record to effectively regulate the market, including the implementation of a private flood insurance market.

As background, we have provided copies of our January 2016 testimony before the Subcommittee on Housing and Insurance regarding H.R. 2901, which includes the 2015 A.M. Best Report on the surplus lines market, and additional documents we have provided to members of Congress and their staff. For purposes of the Committee's May 2 meeting, we would like to focus on two key points: (1) the provision of personal lines products, including flood insurance, is not new for the surplus lines market; and (2) the surplus lines market is well regulated and has a strong track record of performance from both the regulatory and consumer perspective.

Personal Lines and Flood Insurance

Personal lines products are not new to the surplus lines market. A.M. Best's composite of U.S. based surplus lines companies indicates the surplus lines market provides commercial and personal lines products of approximately 85% and 15%, respectively. Surplus lines insurance is generally used to cover risks that the standard market is either unable or unwilling to underwrite. Examples of such personal lines risks include coastal properties exposed to catastrophic storms, high value properties, homeowners in need of coverages or limits that differ from those offered in the standard market, etc. States who deal with catastrophic storms have experienced the normal, downward shift in the standard market's appetite for providing coverage in the wake of catastrophic losses. The surplus lines industry has been able to serve

as an effective solution in such cases, offering consumer options that may no longer exist in the standard market.

Flood insurance is not new to the surplus lines market. Consumers whose risks have not fit within the terms and limits of the NFIP and whose risks have been declined by the standard market have leveraged the surplus lines market for many years. Based on data from six of the 14 states with surplus lines stamping offices (California, Florida, Mississippi, Nevada, New York and Texas), the surplus lines market generated flood insurance premium of \$126.6 million in 2014, \$9.9 million of which was for primary residential flood insurance coverage and \$23.7 million of which was for excess residential flood coverage. While these figures represent a very small proportion of the \$40.2 billion surplus lines market and the \$3.6 billion of premium written by the NFIP, they represent solutions for consumers who (1) need higher limits than the \$250,000 residential, \$100,000 personal contents and \$500,000 commercial limits offered by the NFIP; (2) need enhanced coverage from that offered by the NFIP such as replacement costs of the damaged property rather than actual cash value of the property, additional sublimits, additional structures, or the ability to schedule multiple properties on one policy; and/or (3) need additional coverage such as additional living expense, basements, or business interruption for commercial entities.

Surplus Lines Insurance is Well Regulated

Opponents of H.R. 2901 have described a lack of meaningful regulation over surplus lines carriers writing flood insurance. In fact, it is the state's approach to regulating the surplus lines market, including the critical freedom from rate and form regulation, which allows surplus lines to work as an effective supplement to the standard market. Surplus lines insurers operate with freedom from rate and form regulation, which allows the market to be more innovative, creative and responsive in developing products that meet the needs of consumers with very unique and/or emerging risks, while pricing the product in a financially responsible manner commensurate with the risk. However, freedom from rate and form certainly does not mean that there is any lack of, or freedom from regulation and consumer protection. In fact, in a surplus lines transaction, both the surplus lines insurer and the broker are regulated in a number of substantial ways.

A surplus lines insurer is regulated by the insurance department in their domiciliary state, submitting to all of the same rigorous rules and regulations complying with all financial regulatory requirements and market conduct standards and regulations of its state or jurisdiction of domicile. Each U.S. based surplus lines insurance company is licensed in at least one of the 50 states or other U.S. jurisdictions and must maintain higher capital and surplus levels (the most common threshold being \$15 million in more than 30 states, with some going as high as \$46 million) than standard insurers (which generally average less than \$1 million). Non-U.S. based surplus lines insurers are regulated by state regulators through the NAIC and listed on the Quarterly Listing of Alien Insurers maintained by the International Insurance Department (IID).

It is also important to remember that most surplus lines insurers are subsidiaries of some of the largest insurance groups in the world, most of which are predominately writing standard lines of business. The top 50 insurance groups write 89% of the U.S. surplus lines market. This 89% is regulated by 19 states and the NAIC (as outlined within Appendix B of NAPSLO's Common Misperceptions document).

In accordance with the Nonadmitted and Reinsurance Reform Act, the insured's home state requires a surplus lines broker to be licensed to sell, solicit or negotiate nonadmitted insurance with respect to such insured. In a typical surplus lines transaction, the surplus lines broker (often a wholesale broker with a high level of expertise in the underlying risks) works directly with the retail agent or broker representing the insurance consumer who needs the nonstandard insurance solution. In this regard, both the retail

agent and surplus lines broker are licensed by the state. Perhaps most importantly, and distinct from the standard market, the licensed surplus lines broker is statutorily responsible for (1) placing the coverage with a financially stable, eligible surplus lines insurer and (2) assuring compliance with all of the requirements of surplus lines regulations in the insured's home state, among other requirements. This means they have a heightened level of responsibility for assessing the financial strength and soundness of the surplus lines insurer. In fact, the surplus lines broker can be held liable for the unpaid claims related to an insolvency if the broker fails to make a reasonable inquiry into the insurer's financial condition at the time the business is placed or wrongly determines that the insurer is in sound financial condition. State Insurance Commissioners have the authority to take administrative action and/or revoke the surplus lines broker's license for failure to comply with these statutory responsibilities.

Other regulatory tools and consumer protections in place for surplus lines transactions include:

- Diligent Search Requirements and Export Lists – As described in detail within our testimony before the House Subcommittee on Housing & Insurance, state insurance regulators leverage diligent search requirements and export lists to monitor and control the types of coverages that can be placed in the surplus lines market – both regulating the flow of business between the standard and surplus lines markets. In this regard, it is important to note that 18 states have either added primary flood insurance to their export list or are waiving diligent search requirements for flood coverage because of the need to develop private market solutions for their constituents.
- Unfair Trade Practices Act – Surplus lines insurers are subject to market conduct oversight consistent with the standard market. As an example, surplus lines insurers are subject to the NAIC's Model Unfair Trade Practices Act, which has been adopted in nearly all states and which outlines minimum standards for insurers and prohibited unfair or deceptive acts and practices in such areas as:
 - General misrepresentations to the public, including misrepresentations and false advertising of insurance policies, including misrepresenting the benefits, advantages, conditions or terms of any policy;
 - Disseminating false advertisements or information;
 - Unfair discrimination of policyholders;
 - Violations of state rebating laws;
 - Failing to maintain complaint handling procedures; and
 - Failing to provide claims histories and loss information to policyholders.

These laws also provide Insurance Commissioners with the authority to examine and investigate any insurer to determine if they are or have been engaged in unfair trade practices.

- Complaints Handling and Claims Processing – Surplus lines insurers and brokers have a successful record of responding to consumer complaints and processing claims – from insureds of commercial lines and personal lines products. Treating the policyholder fairly is not only important for the consumer, but for the surplus lines broker's relationship with its retail agent clients. The risk of not treating consumers fairly in these areas is very high and contrary to any long-term business strategy.

Surplus lines policies are subject to the same consumer complaint regimes as admitted policies with complaints generally addressed directly by the insured's broker and/or the insurer. In the case of a complaint escalated to the state, the consumer's home state Insurance Commissioner may work through the complaint with the insured's retail agent and surplus lines broker, and certainly has the authority and incentive to coordinate any work and/or regulatory action with the insurer's domiciliary state. We believe the coordination of regulatory efforts among multiple states is a key strength of the

state-based system of insurance regulation. NAPSLO members work very closely with state insurance regulators, regardless of where they are licensed, to ensure any consumer complaints are appropriately addressed.

- Policy Cancellation/Nonrenewal Requirements – Another misconception about the surplus lines market is that there are no requirements for surplus lines insurers to follow state laws regarding policy cancellation and nonrenewal notice requirements. Several states require surplus lines insurers to comply with the cancellation and nonrenewal notice requirements that apply to all insurers, admitted or nonadmitted.

Opponents of H.R. 2901 suggest surplus lines insurers may cancel a policy, perhaps in advance of an approaching storm, leaving a homeowner uninsurable until after the 30-day NFIP wait period has passed. Again, in our opinion, any insurer conducting business in this way would simply not stay in business long. NAPSLO is not aware of any surplus lines flood insurance policies that have less than a 30-day notice provision for cancellation or nonrenewal. Of the two NAPSLO company members that are actively writing primary residential flood insurance policies on a surplus lines basis, both of their policies include a 45-day cancellation and nonrenewal notice provision, consistent with existing NFIP guidance. Further, some state cancellation and nonrenewal notice requirements provide a longer timeframe than 45 days, which will provide even more time for the consumer under state law.

- Disclosure Requirements – Another misconception about the surplus lines market is that consumers have no way of knowing that surplus lines insurers do not participate in state guaranty funds. In fact, nearly all states require a specific surplus lines notice to be sent to the insured, indicating the insured has purchased a surplus lines policy and that it is not covered by the state’s guaranty fund. NAPSLO’s guiding principles support the adoption of one uniform notice to the insured and suggests the uniform notice to insureds should be provided at the time of delivery of the policy and as a separate document attached to the policy. NAPSLO’s guidance is that the notice should state the following:

An insurer that is not licensed in this State is issuing the insurance policy that you have applied to purchase. These insurers generally do not participate in insurance guaranty funds created by state law. These guaranty funds will not pay your claims or protect your assets if the insurer becomes insolvent and is unable to make payments as promised. For additional information about the above matters and about the insurer, you should ask questions of your insurance general agent, broker or surplus lines broker. You may also contact your insurance department consumer help line.

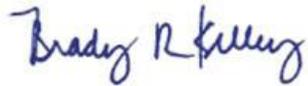
While this concern has been raised by opponents of H.R. 2901, A.M. Best’s report on the surplus lines market highlights its exemplary solvency record. A.M. Best highlights that the surplus lines marketplace is (1) financially secure; (2) dominated by companies with average ratings that exceed those of the overall property/casualty industry; and (3) for the eleventh year in a row, has reported no financially impaired companies. In contrast, the admitted property/casualty industry experienced 207 disclosed financial impairments over the same eleven-year period. We attribute this, in part, to the heightened statutory responsibility of the surplus lines broker and the underwriting discipline demonstrated by surplus lines insurers.

- Any Insurance Commissioner may issue Cease & Desist Orders against nonadmitted insurers from doing business in their state if significant regulatory concerns arise.

When comparing and contrasting the state structure and regulatory tools described above with the NFIP, which has no regulator and where the consumer’s choice of law is the federal court system, we believe it

is clear state insurance regulators provide stronger and more local protections for their consumers. For all of the reasons outlined above, we believe the draft consumer alert presented by the Consumer Federation of America ignores the state and NAIC tools already in place to effectively regulate the surplus lines market.

We appreciate the NAIC's support of H.R. 2901 and applaud your leadership in ensuring the private market is prepared for its implementation. We strongly support state insurance regulation and believe it will provide stronger and more local protections for consumers. Thank you for the opportunity to present this information during the May 2 meeting, and we look forward to working with you as the private flood legislation moves forward.



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