



National Association of Professional Surplus Lines Offices, Ltd.

200 N.E. 54th St. • Suite 200 • Kansas City, MO 64118 • 816/741-3910 • Fax 816/741-5409
www.napslo.org

Richard M. Bouhan
Executive Director

May 29, 2009

The Honorable Thomas E. Hampton
Commissioner, Department of Insurance, Securities and Banking
810 First Street, NE, Suite 701
Washington, DC 20002

Dear Commissioner Hampton:

We are writing jointly from the Securities and Insurance Licensing Association (SILA) Surplus Lines Steering Committee and the National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) to make five comments that we believe would improve and streamline the surplus lines code in the District of Columbia. First, the DC code requires a report from a broker within 10 days of the end of the month, which is very difficult to do if the business was written near the end of the month, which it frequently is. In this regard, the laws of the District of Columbia are more difficult to comply with when compared to other states. We would urge you to adopt a time frame similar to other states. Reporting 30 days after the close of a Calendar quarter is a standard adopted in many states and would seem to serve the purpose of reasonable regulatory reporting.

The second comment is that the requirement for filing a report when there is no information to report would seem to be a burdensome requirement that could be eliminated. With the advent of non-resident surplus lines broker licensing following the adoption of Graham-Leach-Bliley, there is now a large number of surplus lines brokers with non-resident licenses. To require all of them to file a report, even though a large number wrote no business in any given month, is simply an inefficient process.

The third comment has to do with the diligent search requirement. All parties agree that (unless some exemptions apply) the diligent search must be completed prior to accessing the surplus lines market. In many instances however, the insurance producer has no way to know in advance if a risk must be placed in the surplus lines market. Only when an independent insurance agent is unable to place the risk in the admitted markets, does the agent then contact the surplus lines wholesaler. The independent agent must split a commission with the surplus lines wholesaler, so the independent agent will exhaust efforts to place the business in the admitted markets prior to contacting the surplus lines wholesale broker. It would be terribly inefficient for the surplus lines wholesale broker to conduct yet another diligent search when the retail independent agent has already determined that no admitted market exists. The laws of 46 states accommodate this production model utilizing the surplus lines wholesale production system by recognizing that the diligent search can be conducted by the producing broker. NAPSLO has compiled a compendium of the laws permitting the

May 29, 2009
Page Two

retail agent to conduct the diligent search. If you would like a copy, please contact steve@napslo.org.

To be clear, there are retail agents who are also licensed as surplus lines brokers. Surplus lines brokers using this "retail" production model would conduct the diligent search because they are also the producing broker. In the retail production model the producing broker (who also has a surplus lines license) accesses the surplus lines company directly without the use of a surplus lines wholesaler. Again, the laws of 46 states are written to accommodate either the wholesale production model or the retail production model.

Washington, DC has one of the few codes where the laws appear to mandate that the surplus lines licensee conduct the diligent search. It states that the surplus lines licensee must be unable "after diligent effort to procure policies to cover the kind or kinds of business required from companies duly authorized to transact business in the district." I am told by the surplus lines stamping offices in NY, TX, and CA that between 66 percent and 80 percent of surplus lines transactions utilize the wholesale production model. We would like to request that the laws be clarified so the wholesale production model may be utilized in Washington, DC.

The fourth comment concerns the code section indicating the the license could be revoked if the agent placed policies with "any unauthorized company risk which could be placed with an authorized company except for abnormal provisions of the policy." Many times a policy is placed in the surplus lines market because there are unusual coverage requirements needed by the insured. One that comes to mind is coverage for peer review committee activities of a hospital. Coverage for these activities is frequently unavailable from admitted markets. If the hospitals required coverage for its peer review activities, it would generally need to access the surplus lines markets. Given the fact that many times an insured risk is placed in the surplus lines markets because of the abnormal provisions in the policy, such as coverage for a peer review committee, we would request that you delete this requirement.

Finally, the fifth comment is about the provision allowing the broker's license to be revoked or non-renewed if the broker procured policies from "unauthorized companies whose standards of solvency and management do not meet the requirements necessary for the protection of the policyholders." We believe the language is not only vague, but it also could provide the basis of an E&O claim in the event of an insolvency. Since the standard is in the code, it is likely to be proffered as the proper standard of care in an E&O claim. Obviously after an insolvency it could be argued that the placement did not "meet the requirements necessary for the protection of the policyholders." Since many insolvent companies have an "A" rating immediately before the insolvency, it is difficult for the broker to know whether a company may eventually face financial difficulties. It is difficult for an experienced actuary or a rating agency to know whether a company's reserves are accurate. Consequently, it is unlikely that a surplus lines broker would be able to know if an "A" rated company could face financial

difficulties. Many states require the broker to place business with a company that appears to be financially sound at the time of the placement. This standard would continue to require the broker to use financially sound companies, but it focuses on the company at the time of the placement, instead of the standard using hindsight to determine if the company met the "requirements necessary for the protection of the policyholders."

Below is the Washington, DC surplus lines code with the suggested additions in bold and the suggested deletions in parentheses.

Any person may be licensed as a surplus lines insurance producer under chapter 11A of this title to procure policies from companies which are not authorized to do business in the District where such person is, after a diligent effort **by either the surplus lines licensee or the licensed producing broker,** unable to procure policies to cover the kind or kinds of business required from companies duly authorized to transact business in the District. Each **surplus lines licensee** (agent or broker so licensed) shall pay to the Collector of Taxes through the

Commissioner on February 1st and August 1st of each year, a sum equal to 2 per centum of the amount of gross premium upon all kinds of policies procured by him during the immediately preceding 6 months period ending December 31st and June 30th respectively, and in default of such payment the Commissioner, through the Corporation Counsel, may bring Suit to recover the same. Each **surplus lines licensee** (agent or broker so licensed to procure policies from unauthorized companies) shall execute and file with the Department on or before the **30th** (10th) day **after the end** of each **calendar quarter** (month) an affidavit covering the transactions for **the quarter**(of the previous calendar month) setting forth:

- (1) The description and location of the insured property or risk, and the name of the assured
- (2) The amount insured in the policy or contract
- (3) The gross premiums charged thereon
- (4) The name of the company whose policy or contract is issued, and the kind or kinds of business effected; and
- (5) That the **producing broker, or if the surplus lines licensee is the producing broker, the surplus lines licensee** was unable to procure the policies or contracts required to protect the property or risk described in the affidavit from companies duly authorized to transact business in the district.

(b) Each **Surplus lines licensee** (agent or broker so licensed to procure policies from unauthorized companies) shall keep a separate account of the business transacted there under, which shall be open at all times to the inspection of the Commissioner. The license provided for in this section may be revoked or renewal thereof refused for failure to pay the tax or to file the affidavit specified herein or if the **surplus lines licensee, or the surplus lines licensee in reasonable reliance upon the producing broker,** procured policies from unauthorized companies without exercising diligent effort to secure the required business in duly authorized companies, or if the **surplus lines licensee** (agent or broker) procured policies from unauthorized companies **that did not appear to be financially sound at the time of the placement** (whose

standard of solvency and management do not meet the requirements necessary for the protection of policyholders), or if the surplus lines licensee (agent or broker) (has placed with any unauthorized company any risk which could be placed with an authorized company except for abnormal provision of the policy), (agent or broker) has procured from an unauthorized company any policy which covers a risk of a class generally covered in the District by authorized companies and which authorized companies would cover at a rate not higher than that charge by authorized companies or other District risks of the same class

Thank you for the opportunity to comment. If you would like to discuss these issues in person, please let us know.

Yours truly,

A handwritten signature in cursive script that reads "Steven P. Stephan".

Steven P. Stephan, J.D., CPCU, ARe
Director of Government Relations

A handwritten signature in cursive script that reads "Rebecca Noble".

Rebecca Noble
Chair, SILA Surplus Lines Steering Committee