SLA

THE SURPLUS LINE ASSOCIATION OF | CALIFORNIA

Information for Legislators and Regulators

This informational brochure will explain who and what we are, who we represent, and how important and necessary our industry is to California's insurance consumers and the state's economy.

www.slacal.com

Introduction

Thank you for your interest in the Surplus Line Association of California (SLA) and in the surplus line insurance industry.

If you are not already familiar with our organization or our industry, you are not alone. Because the everyday insurance needs of most consumers are covered by insurers who are admitted to sell insurance in the State of California, our segment of the industry is largely unknown and often overlooked. However, without surplus line (or nonadmitted) insurance, many California businesses would not be able to obtain coverage, and neither those businesses, nor the consumers they serve, would be protected. Additionally, without the protection of insurance, many companies or industries that contribute significant amounts of jobs and taxes to this state would not choose to conduct business at all, if the risks outweighed the benefits. **More than 100,000 California businesses, which pay $17 billion annually in state and federal taxes, employ 1.75 million workers and pay them more than $50 billion a year, rely on surplus line insurance.**

One of the most enduring myths about surplus lines is that this type of business is unregulated, but the nonadmitted market in California is well and diligently regulated. In fact, 21 sections of the California Insurance Code (1760 through 1780) deal specifically with surplus lines, and all brokers who place nonadmitted policies in the State of California are required to be licensed and in compliance with all state laws and regulations governing the industry. The SLA, appointed in 1994 as the statutory surplus lines advisory organization to the California Department of Insurance (CDI), helps brokers remain in compliance; we examine every nonadmitted filing placed in California (more than 700,000 per year) to ensure that our members comply with all the legal requirements necessary to place policies lawfully in the state.

Our mission is to ensure that a responsive and lawful surplus lines insurance market is maintained in California. Our measure of success in this respect is that the consumer is protected, the needs of the regulators are well-served, and unlawful activities are curtailed. Through a professional and committed organization, utilizing state of the art technology, we respond to the needs of the California consumer, our membership, and appropriate public agencies. We provide education, processing, evaluation, and dissemination of surplus line data and information to help ensure the financial integrity and stability of the nonadmitted market.

We look forward to working together with you to help ensure a fair, healthy and competitive surplus lines marketplace for California insurance consumers.

Sincerely,

Benjamin J. McKay

Benjamin J. McKay, J.D., M.P.A.
CEO and Executive Director
Surplus Line Association of California

Surplus Line Market Basics

The Surplus Line Market is a Well-Regulated and Well-Functioning Market

The surplus line market is often misunderstood. The surplus line market is not unregulated, as some believe. Surplus line insurance carriers are regulated in their domiciliary jurisdictions and must be eligible under federal and California law before business can be placed with them (exported to them). Additionally, the surplus line broker in California is licensed and regulated directly by the California Department of Insurance (CDI). Surplus Line brokers are also subject to periodic audits by the California Department of Insurance. In summation, the surplus line market is a well-functioning, well-regulated market that serves as an appropriate place for consumers to obtain coverage when the admitted market is unable to meet their insurance needs.

State and Federal Regulations

There are 21 sections of the California Insurance Code devoted to regulating surplus lines. Sections 1760 through 1780 provide the surplus line broker licensing requirements, policy placement conditions with a surplus line insurer, and the prerequisites of a surplus line insurer writing business in California.

Surplus Line Broker Licensing Requirements

To transact business as a surplus line broker, a resident broker must hold a property and casualty (P&C) license, which requires passing the fire and casualty examination for broker-agents, before applying for a surplus line license. In addition to holding a P&C license in their resident state, a non-resident broker must also hold a surplus line license in his/her resident state before applying for a surplus line license. The broker must complete an application, complete a Surplus Line and/or Special Line Certification form stating the applicant has read the sections of the California Insurance Code pertaining to surplus lines, and file a surety bond of $50,000 to the people of the State of California.

To maintain the surplus line license, the resident broker must complete a renewal application and pay a fee to renew his/her license every two years. To maintain the P&C license, the resident broker is required to complete continuing education each license term. The non-resident broker must complete the continuing education required by his/her state of residence.

For an applicant applying for a business entity surplus line license, brokers transacting under the organizational license must be named under the license and a surety bond of $50,000 must be filed to the people of the State of California.

Conditions of Placement with a Surplus Line Insurer

Before a risk is placed in the surplus line market, the surplus line broker must ensure that insurance is not generally available from admitted insurers qualified to write that type of insurance. Except for narrow exemptions for commercial insureds, specialty lines, and coverages listed on the "export list" maintained by the CDI, brokers must complete an affidavit (Diligent Search Report or SL2 form) documenting the diligent search effort to place the risk in the admitted market. Insurance buyers must sign a disclosure statement (D1 form) acknowledging that the risk is being placed with a nonadmitted insurer and that guaranty fund protection is unavailable to the buyer. If the SL2 form shows that three admitted insurers that actually write the particular type of insurance decline the risk or fewer than three admitted insurers write the type of insurance, it is prima facie evidence that a diligent search was made.

The broker must not place insurance with a surplus line insurer solely for obtaining a premium less than the lowest premium offered by an admitted carrier. A premium tax is levied on all surplus line transactions to the insured with payment remitted to the CDI by the broker. The broker must submit the policy and required documents to the stamping office for review to verify that the placement was handled correctly by the broker.

Brokers are audited by the Premium Tax Audit Bureau of the CDI to ensure compliance with tax filings.

Eligibility Requirements for a Surplus Line Insurer

Surplus line insurers on the List of Approved Surplus Line Insurers (LASLI) must demonstrate their financial stability, reputation and integrity; maintain a minimum of $45 million in capital and surplus at all times; have three years' seasoning (or qualify for an exception); have a valid license to transact insurance in their domicile; file financial information with the CDI; and adhere to specific capitalization, investment and solvency standards established under the California Insurance Code.

On July 21, 2011, the federal Nonadmitted and Reinsurance Reform Act (NRRA) went into effect, establishing federal guidelines for surplus line insurer eligibility in all states. The SLA worked with California regulators to adapt California law to the new federal standards, which led to the creation of Assembly Bill 315. AB315 established the requirements for surplus line insurers not on the LASLI to write policies in California:

- **Foreign companies** (U.S. companies domiciled outside California) must maintain a minimum capital and surplus of $45 million and be authorized to transact in their state of domicile.
- **Alien companies** (domiciled outside the United States) must be included on the NAIC's Quarterly List of Alien Insurers.

Frequently Asked Questions

Q. What is surplus line insurance?

A. The surplus line market (also known as excess lines or nonadmitted market) is comprised of insurers who provide coverage that is unavailable to businesses in the admitted market, generally for distressed, unique or high-capacity risks that standard insurers will not cover. In general, surplus line insurance covers risks that standard insurance, such as what you might purchase for your vehicle, will not cover.

Q. What is the difference between admitted and surplus line (nonadmitted) insurers?

A. Admitted insurance companies are licensed to sell insurance in a state and are subject to that state's rate and form regulations, while nonadmitted insurance companies are not; they may be licensed in another state or country. Instead, surplus line brokers, who place business with these nonadmitted carriers on behalf of consumers, are licensed by the state.

Q. Why are surplus line insurers needed?

A. For insurance consumers who cannot secure insurance from admitted companies, the surplus line market provides additional capacity and innovative underwriting practices that admitted carriers cannot offer. Without the surplus line market, businesses might be forced to self-insure their exposures, or go without coverage. Surplus line policies protect both these businesses and the customers they serve.

Q. What types of risks do surplus line policies cover?

A. There are many types of risks that the surplus line insurance market covers. It would be impossible to provide a comprehensive list here, but some examples include large commercial construction projects, film and entertainment productions, oil field contractors, special agricultural and logging risks, some flood and earthquake risks, tattoo parlors, amusement parks and carnivals, just to name a few.

Q. Why have I never heard of surplus line insurance before?

A. The average insurance consumer's personal insurance policies, such as auto or homeowners' insurance, are generally written by admitted carriers. The overwhelming majority of surplus line coverage is written to insure commercial risks.

Q. What does the surplus line marketplace mean to California's economy?

A. Surplus line insurers provide insurance that would otherwise be unavailable for distressed, unique or high-capacity risks. Without the surplus line marketplace, those businesses would not be able to operate in the capacity they do, or perhaps even at all, due to the liability concerns involved, which would mean fewer jobs and fewer services for Californians. Additionally, surplus line policies generate approximately $12 billion in annual premiums in California, and that premium volume alone provides a considerable amount of tax revenue to the state.

Q. What is the purpose of the Surplus Line Association of California (SLA)?

A. The SLA monitors surplus line brokers who do business in California and helps them comply with all state surplus line laws and regulations when they write business. All surplus line policies written in the state must be filed with SLA so that it may review all filings for compliance and ensure that premium taxes are collected. The California insurance commissioner in 1994 designated the SLA as the surplus line advisory organization for the California Department of Insurance (CDI). While the SLA has no specific regulatory power, it assists the CDI in ensuring broker compliance with all applicable laws and regulations.

Q. Is the SLA a private, public, or nonprofit organization?

A. The SLA is a 501(c)(6) not-for-profit organization governed by a plan of operation approved by the CDI and the SLA Board of Directors.

Q. How is the SLA funded?

A. The SLA levies a small fee, called a "stamping fee," on every surplus line policy filed. While the fee may vary from year to year, depending on the anticipated needs of the organization, it is generally a fraction of 1 percent of the total premium charged on each policy. (At the time of the publication of this document, the fee was 0.25 percent, or $1 in stamping fees for every $400 charged in premiums.) These stamping fees are paid by the consumers who take out surplus line policies. **The SLA receives no public funding for its operations from the state of California or its taxpayers.**