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# A Deep Dive Into the Diligent Effort (Search) Requirement

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**WRITTEN BY**

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New York Partner **Zachary Lerner** authored an article for Insurance Journal identifying a few of the frequently asked questions and areas of compliance deficiencies in the marketplace relating to the "diligent search" requirement that should be considered when operating a surplus lines brokerage firm or otherwise performing due diligence relating to the acquisition of a surplus lines broker licensee. Many alien (non-U.S.) insurance carriers write surplus lines insurance coverage via their inclusion on the NAIC IID Quarterly Listing of Alien Insurers, and there has been exponential growth in the formation of "domestic surplus lines insurers" that are U.S.-based insurers authorized for the express purpose of writing only surplus lines insurance, Lerner explains.

"However, one of the principal barriers to the placement of insurance policies by surplus lines insurers has been the "diligent effort" or "diligent search" requirement imposed on surplus lines brokers," he writes. "A condition in most states for placing insurance through the surplus lines market is the utilization of a surplus lines broker that must first search the admitted market for available insurance coverage. While some industry participants see this requirement as an antiquated hurdle of yesteryear, others view this requirement as essential for protecting the traditional, highly-regulated admitted market."

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**A Deep Dive into the Diligent Effort (Search) Requirement**

By Zach Lerner | January 22, 2024

The excess and surplus lines insurance market is a rapidly-growing avenue for the placement of insurance policies in the United States.

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However, one of the principal barriers to the placement of insurance policies by surplus lines insurers has been the "diligent effort" or "diligent search" requirement imposed on surplus lines brokers. A condition in most states

for placing insurance through the surplus lines market is the utilization of a surplus lines broker that must first search the admitted market for available insurance coverage. While some industry participants see this requirement as an antiquated hurdle of yesteryear, others view this requirement as essential for protecting the traditional, highly-regulated admitted market.

In the old days, the surplus lines market was traditionally deployed for bespoke, hard-to-place insurance risks, which currently include cyber insurance, representations and warranties insurance for mergers and acquisition (M&A) transactions, and insurance for cannabis-related businesses.

Today, however, the surplus lines market also increasingly supports risk exposures traditionally within the purview of the admitted marketplace, such as homeowners coverage and commercial automobile insurance (to the extent permissible under motor vehicle laws). In addition, the explosion of “insurtech” carriers and brokers has increased the demand for app-based “on demand” binding of coverage. As such, the diligent search requirement has become more important to consider than ever.

This article identifies a few of the frequently asked questions and areas of compliance deficiencies in the marketplace that should be considered when operating a surplus lines brokerage firm or otherwise performing due diligence relating to the acquisition of a surplus lines broker licensee.

**Is the diligent search requirement still around in most states?**

Yes, although many states contain exemptions and a few have removed it altogether. To our knowledge, at least four states (Louisiana, Mississippi, Virginia and Wisconsin) have eliminated the requirement. Moreover, some states are beginning to exempt surplus lines brokers from the diligent search requirement with respect to commercial risks when a retail producer is involved. For example, in Illinois, under 215 Ill. Comp. Stat. 5/445, a surplus lines producer may procure commercial lines coverage through the E&S market without conducting a diligent search of the admitted market “if the risk was referred to the surplus line producer by an Illinois-licensed insurance producer who is not affiliated with the surplus line producer.”

**Are regulatory filings required to evidence satisfaction of the diligent search?**

In many states, yes. Some states, like New York, even require that a producing retail broker, if in the chain of sale, complete and sign a separate affidavit verifying the satisfaction of the completion of the diligent search requirement and file it with a state insurance department or a surplus lines “stamping office” (although such affidavit is filed by the excess line broker in New York). Some other states, by contrast, simply require that adequate records be maintained by the surplus lines broker evidencing satisfaction.

**How can a declination be obtained?**

Most states do not direct surplus lines brokers as to how the declination must be obtained; for example, New York’s required affidavits only ask for the date of declination and the reason why the broker believes that the insurer would have considered writing the coverage. Florida’s “Statement of Diligent Effort” form expressly requires the attachment of any declinations obtained electronically, and a number of states expressly acknowledge the permissibility of oral declinations obtained from a representative of the insurer or the insurer’s agent, although

the surplus lines broker should keep written records of these declinations as well.

**Does the diligent search need to be conducted each and every time a policy is issued or renewed?**

Some states expressly indicate that the diligent search requirement be satisfied on a "per risk" basis, including each and every time an insurance policy is renewed. For example, per guidance promulgated by the Excess Line Association of New York, "[a] diligent effort must be performed for each policy being placed — a declination may not be used for multiple policies. Likewise, a new diligent effort must be undertaken upon the renewal of a policy." Similarly, under guidance published by the California Surplus Lines Association, "[a diligent] search must be performed on all new and renewal policies (even if the insured wants to remain with the surplus lines insurer)." In Florida, per Fla. Stat. § 626.916, "[d]eclinations must be documented on a risk-by-risk basis."

There is enforcement history on this issue. For example, under a 2018 New York consent order, the New York Department of Financial Services found that a surplus lines broker "only obtained declinations from three authorized insurers once annually for a single policy … and then relied upon the single annual declination with respect to all other insureds who received policies" in violation of New York insurance laws.

There are some states that do, however, allow for the diligent search to be "recycled" in limited situations. In Illinois, under 215 Ill. Comp. Stat. 5/445, where the surplus lines producer has contracted to place "program" business with a carrier for insureds with similar characteristics receiving similar contract terms, the diligent search need only be conducted annually rather than individually for each contract. In states that do not expressly require that the diligent search be completed on a per-risk basis, there is an argument that recycling a search could be appropriate if there is a reasonable basis to believe that admitted market availability has not changed, but such practice comes with regulatory compliance risk.

**How many declinations are required?**

Many states expressly require that at least three declinations be obtained from licensed insurers as a reasonable proxy for demonstration that coverage is not readily available in the admitted market (although some states, like Ohio, require five or more declinations), but this is only a necessary rather than sufficient condition in some states. For example, in Florida, per ICR Bulletin 89-100 (April 11, 1989), the requirement to obtain three declinations is not a maximum, but a minimum "level of effort that must be exerted in an attempt to find an authorized carrier."

Some states require fewer or greater number of declinations depending on the type of insurance coverage. For example, Florida only requires one declination relating to property coverage for residential structures that have a dwelling replacement cost over $700,000. On the other hand, some states require additional declinations from risk pools; in California, per Cal. Ins. Code § 1763.5, private passenger automobile coverage must first be submitted to the California Automobile Assigned Risk Plan before being exported to the surplus lines insurance market.

Some states do not impose a minimum number of admitted market declinations, and while this may at first blush appear to provide more leniency for the surplus lines broker, such silence imposes a greater burden in a few states. For example, in Maine, under Bulletin 457 (April 14, 2021), "doing a specific number of inquiries does not mean that the producer has fulfilled this requirement. Rather, this is a function of many variables, including for example the type of insurance sought and the coverage limits needed." In fact, in Maine, if the coverage "exists in

the admitted market" at all, the coverage is not exportable, "even if a producer is blocked from placing an account with an authorized insurer … ."

**Can any licensed carrier provide a declination?**

No, as many states require that the surplus lines broker have a "reason to believe" the licensed carrier may write the coverage. In New York, N.Y. Comp. Codes R. & Regs. tit. 11, § 27.3 includes the following as "reasons to believe" that an authorized insurer might consider writing the type of coverage desired: (1) recent acceptance by the insurer of similar coverage, (2) advertising by the insurer or its agent that the insurer is willing to consider similar coverage, (3) media communications indicating the insurer is willing to accept similar coverage, (4) communications with insurance professionals, risk managers, trade or surplus lines associations, or the New York Department of Financial Services that would indicate the authorized insurer might consider writing the coverage, or (5) any other valid basis for making such decision.

Additionally, per New York's regulation, declinations from multiple authorized insurers under common control will not count as multiple declinations unless such insurers operate as distinct and autonomous entities, and for underwriting purposes, compete with each other for the same type of coverage or class of insurance. Furthermore, in some states, such as West Virginia, coverage may not be placed with a surplus lines insurer that is an affiliate of a licensed insurer from which the declination has been obtained, see W. Va. Code § 114-20-4.

**What differences between an admitted and a surplus lines insurance policy may be used to justify a declination?**

First and foremost, many states expressly state that price (premium amount) alone is not a permissible reason for a surplus lines broker to obtain a declination from an authorized carrier. In addition, a few states identify other differences that are insufficient to demonstrate a true declination. For example, in California, a declination does not qualify when the coverage is artificially divided into multiple contracts for the purpose of avoiding admitted market availability; however, if a portion of coverage is truly not available in the admitted market and it can be shown that a surplus lines insurer will accept the entire coverage but not the rejected portion alone, the entire class of risk may be exported only with insurance commissioner's approval. See Cal. Code Regs. tit. 10, § 2137 and Cal. Code Regs. tit. 10, § 2138.

**How is the diligent search satisfied for group policies?**

This is an area not addressed under most state insurance codes; however, one state that offers express leniency is Illinois. Under 215 Ill. Comp. Stat. 5/445, "[f]or a master policy insurance contract, a licensed surplus line producer may make the required diligent effort to procure the insurance from authorized insurers annually for the master policy rather than individually for each insured that is added during the policy period." New York provides flexibility for some (but not all) types of groups, including certificates issued through risk purchasing groups (RPGs) whereby declinations may be obtained for all members of the group when coverage is procured within a 30-day period (see N.Y. Comp. Codes R. & Regs. tit. 11, § 301.6). Certain other states completely exempt the surplus lines broker from the diligence search requirement as to coverage issued to and through RPGs.

There is generally enhanced risk that a state will require a diligent search to be completed as to a member

residing therein when the term “home state” is defined for purposes of surplus lines regulatory jurisdiction to include members of groups that pay premium “from their own funds” or similar terminology, even if the master policyholder is located in another U.S. jurisdiction. In addition, just because the state where the master policy is issued may provide leniency as to the diligent search requirement in the group context does not mean that another state where a group member may reside will adhere to such relaxed approach.

**Who is responsible for conducting the diligent search?**

Many states allow a retail (non-surplus lines) broker to conduct the diligent search, but this does not necessarily absolve the surplus lines broker from liability for the failure of a surplus lines insurance placement to be supported by proper declinations. For example, in Florida, per Bulletin 97-7 (June 16, 1997) “[s]urplus lines agents must exercise prudent business judgment when evaluating the reasonableness of the producing agent’s statement of diligent effort. Failure to do so may result in disciplinary action, including revocation of the agent’s license.” By contrast, some states, such as Connecticut, put the burden exclusively on the retail agent (see Bulletin SL-4, July 25, 2013). Some states, on the face of their surplus lines statutes or in other guidance, require that the surplus lines broker conduct the diligent search without reference to satisfaction by a retail broker or other third party.

**Are there more general exemptions from the diligent effort requirement?**

Yes. First and foremost, the Nonadmitted and Reinsurance Reform Act of 2010 stipulates that a surplus lines broker is not required to conduct a diligent search of the admitted market if the insured is an “exempt commercial purchaser,” assuming certain disclosure requirements are met. Some states have additional “industrial insured” exemptions that, in some situations, also alleviate the placement from other surplus lines regulatory standards. A number of states maintain “export lists,” which are compilations of coverages that the applicable commissioner has determined have no admitted market availability. Surplus lines brokers cannot make this determination on their own; only a state can affirmatively exempt such coverages via inclusion on their export lists.

These are just some of the many issues to consider when striving to comply with the surplus lines diligent effort requirement across the various U.S. jurisdictions.

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