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Top 10 Queries for Insurers Entering Surplus Lines Market

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John Emmanuel, New York Partner and member of Locke Lord's Board of Directors, authored an article featured as an "Expert Analysis" in Law360. Emmanuel discusses 10 of the many considerations for insurers who plan to enter the growing surplus lines market. He explains that "Like the licensed market, the [surplus lines] market is still ultimately regulated on a state-by-state basis with variations in application and enforcement."

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Top 10 Queries for Insurers Entering Surplus Lines Market

The U.S. surplus lines market has seen double-digit growth over the past five years and shows few signs of slowing down. It continues to serve an important function, filling the gap in admitted coverages and being at the forefront of product innovation.

At the end of 2023, premiums reached nearly \$73 billion according to data from just the 15 state surplus lines offices, as reported by the Wholesale & Specialty Insurance Association. The growth has been the product of renewed emphasis on the market by existing participants, together with an influx of new entrants, whether as underwriters or on the distribution side.

As new parties enter the market, we consider below the top 10 questions about the surplus lines market.

1. Is the surplus lines market unregulated?

Let's get this one out of the way. The most common inclination when talking about the surplus lines market is to proclaim that it is unregulated. This is not the case. While the primary benefit of the state surplus lines framework provides insurers freedom of state insurance form and rate filing requirements, it is nonetheless a regulated market, and often subject to state-specific differentiation within the regulatory framework.

The regulatory oversight tends to focus on the brokers, but not exclusively. First and foremost, a surplus lines policy may only be placed via a surplus lines broker who must be specially licensed for that purpose, and who is already licensed in that state as a general property/casualty agent or broker.

Surplus lines brokers are also not allowed to place business with unauthorized insurance companies unless the companies are licensed in their home jurisdiction, meet certain minimum capital and surplus standards, and are

deemed eligible in the state to write surplus lines business.

Second, before a risk can be placed with a surplus lines insurer, a diligent search must be made by the surplus lines broker to try and place the coverage in the admitted market. Additionally, the broker must allocate and pay surplus lines taxes and file regular reports with each state. To ensure that buyers understand the limited regulatory oversight and protection these transactions involve, almost all states require a clear disclosure of these limitations to the policyholder.

Outside the placement requirements, states regulate the market in other ways.

For example, some states specifically require that surplus lines insurers follow the cancellation and nonrenewal requirements applicable to admitted insurers — Florida even has its own specific surplus lines nonrenewal statute.^[1] Some states apply defense-within-limits restrictions, standard fire policy requirements or other generally applicable statutes, such as unfair trade practice statutes, to surplus lines.

2. In addition to the surplus lines broker, can there be multiple parties in the distribution chain?

Yes, multiple intermediaries can be involved in a surplus lines' placement. In fact, in most cases there is a retail producer involved. A retail producer, who is not a surplus lines broker, and who may not be able to find an admitted insurer to write the risk, refers that placement to a surplus lines broker who then places the risk with the surplus lines insurer.

In fact, there is a subset of states that requires that the retail producer be the one to complete the diligent search requirements and the accompanying affidavit.

For example, Connecticut Bulletin SL-4 states “it is the Department’s position that the responsibility to fulfill the due diligence requirement falls upon the insured’s retail agent, given nature of the authority of surplus lines brokers and the timing of the steps involved in surplus lines transactions.”

There can also be a wholesale producer involved who is closest to the insurer.

3. Can surplus lines be sold online?

Yes, with the growing desire for digital sales of insurance, there is a need to meet this with the instant placement of insurance. That said, it can be difficult for surplus lines coverages particularly because almost all states require the diligent search of the admitted market.

Unless the risk is on a state’s export list or the insured is in one of the minority of states that have eliminated the diligent search, satisfying this requirement in the digital world can often lead to delays before the policy can be issued. The use of technology, or an update of state regulations, could allow the placement process to speed up to catch up with the demand for instant placement of insurance, but this hurdle remains.

4. Can surplus lines brokers have binding authority?

Yes, insurers can provide binding authority to surplus lines brokers, but there are some state regulatory requirements that must be followed.

Under California law, for example, in order for a surplus lines insurer to delegate binding authority to a surplus lines broker, there must be a written agreement between the insurer and the broker.^[2] That said, with regard to underwriting activities, California makes clear that the ultimate decision as to rate setting and establishing underwriting guidelines must be performed by the surplus lines insurer outside California.

New York is another state that requires a written binding authority agreement, a copy of which must be submitted to the Excess Line Association of New York when entered into between the parties.^[3]

5. What about surplus lines advertising?

Surplus lines insurers are typically restricted from specific advertising into states in which they are not admitted. While advertising restrictions vary by state, they generally prohibit any direct marketing to insureds.

For example, while marketing in trade publications and marketing directed at licensed surplus lines brokers is generally permissible, some states have restrictions on the mentioning of specific products in the same advertisements that mention the name of a specific surplus lines insurer. In addition, a website maintained by a surplus lines insurer is considered an advertisement and could potentially violate state insurance laws if not presented properly.

New York, for example, expressly prohibits any person from calling attention to a surplus lines insurer by advertisement or public announcement, with certain exceptions, such as to the insurance industry in insurance trade publications that are not directed to prospective insureds in a national publication.

6. What amount of capital and surplus is needed to write nationwide?

The Nonadmitted and Reinsurance Reform Act, or NRRA, greatly simplified the eligibility requirements for surplus lines insurers. Under the federal law, a U.S.-domiciled surplus lines insurer is required to maintain at least \$15 million in capital and surplus — although some states have higher requirements, such as California, which is \$45 million, and New York, which is \$48 million — and is then authorized to write the same lines in its home state in all other states.

Non-U.S. insurers need to obtain listing on the [National Association of Insurance Commissioners](#)' quarterly list of alien insurers to do so.

That said, while most states to date have implemented the NRRA into their own state laws, about half maintain white lists or surplus lines eligibility lists, which require the insurer, or in some cases the broker, to file an application for inclusion on the list. States may require such a filing so that they can confirm that the unauthorized insurer complies with the requirements of the NRRA.

7. How are claims adjusted in the surplus lines market?

Adjusting activities are subject to the same requirements as adjusting policies issued by licensed companies. As an initial matter, there are approximately 18 states that do not require adjusters to be licensed. With respect to all other states, with some variation, in order for someone to adjust surplus lines claims — whether based in the U.S. or outside — both the entity performing the adjustment of claims and the individual are required to satisfy the adjuster licensing requirements, unless an exception is satisfied.

It is worth noting that at least one state, Louisiana, statutorily requires surplus lines insurers to “ascertain from the [Louisiana] commissioner of insurance whether the person performing the adjustment holds a license” in order to be eligible to adjust the claims.^[4] This requirement specifically applies not only to licensed companies but surplus lines insurers as well.

8. Can a surplus lines insurer engage in reinsurance?

Yes, a surplus lines insurer can reinsurance risks, even admitted policies, similar to their admitted company counterparts. That said, ceding companies, if they seek to take credit for reinsurance of risks reinsured by a surplus lines insurer, must ensure that the surplus lines insurer satisfy an authorized category where such credit can be taken. Otherwise, collateral would be required.

For U.S. surplus lines insurers in particular who are assuming risks, they may not squarely fit into the licensed category, and thus may need to obtain another status — such as accredited, certified or reciprocal status — in order for the ceding company to take credit. The specific language of the ceding company’s state of domicile credit for reinsurance laws should be reviewed to determine whether a category is satisfied.

9. Are surplus lines carriers restricted in what lines they can write?

Yes, not all insurance coverages are exportable to the surplus lines market and most states limit exportable coverage to property and casualty lines only. In addition, some states further limit the type of coverages exportable to specific kinds of property and casualty coverages.

New York, for example, statutorily lists only those coverages that may be written on an excess lines basis and coverages not available for export, including financial guaranty insurance, legal services insurance, mortgage guaranty insurance and workers’ compensation insurance.

Recently there has also been a move toward the allowance of certain accident and health risks into the surplus lines market. In 2019, the National Association of Insurance Commissioners published a guideline on nonadmitted accident and health coverages to assist states in amending their laws to allow the writing of certain accident and health coverages in the surplus lines market, such as “short term medical, international major medical, excess disability, high-risk disability and other similar coverages,” but not “comprehensive health plans, Medicare supplement insurance and standard disability insurance coverage.”

In addition, many states prohibit surplus lines insurers from satisfying mandatory insurance coverages, such as automobile financial responsibility requirements. Some states require that this coverage be satisfied only by licensed insurance companies rather than surplus lines insurers.

10. I want in. Should I form my own or purchase a surplus lines insurer?

When looking to enter the surplus lines market as a carrier, a question arises as to whether it's preferable to buy or form an insurer. Typically, from a timing perspective it used to be quicker to buy an already established surplus lines insurer than to form one de novo. Seasoning, where an insurer would be required to have a minimum number of years of experience prior to granting eligibility, would often be a barrier to forming and starting an insurer that can operate nationally quickly.

Following the adoption of the NRRA, states eliminated such requirements, thereby allowing the formation of a surplus lines insurer to become a very popular way to enter the market in a quick and efficient manner without having to go through the acquisition of control approval process. Further, if the carrier is formed in one of the 22 states with domestic surplus lines legislation, the insurer can write surplus lines coverage in its domestic state as well.

Conclusion

These are just 10 of the many considerations that make the growing surplus lines market special and unique. Like the licensed market, the market is still ultimately regulated on a state-by-state basis with variations in application and enforcement.

[1] Fla. Stat. Ann. § 626.9201.

[2] Cal. Bulletin 96-8.

[3] N.Y. Ins. Law § 2122.

[4] La. Stat. tit. 22 § 1676.

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