

Navigate Surplus Lines Market Liability


There are many reasons why some risks are unacceptable to standard lines carriers. Standard lines carriers do not favor clients with adverse loss histories. Most shy away from startups in certain higher-risk industries that have no loss history. Other risks are so rarely seen that standard lines carriers cannot justify the cost and expense of admitting paper for them, such as hole-in-one coverage or specialized machinery used only in a limited segment of an industry. Finally, some risks require significant limits or involve complicated hazards that standard lines aren't equipped to write, such as a liability policy for a fireworks manufacturer or a property policy on a communications satellite. Whether the risk is big or small, the agent must look to the excess & surplus lines market for these hard-to-place risks.

Most states have very specific laws and regulations regarding the sale of non-admitted insurance products. For example, many states have specific language and other regulations about what information must be disclosed to the customer and how such disclosure must be made. Failure to follow these requirements can result in strict liability for the agent who sold the policy. In other words, if the agent sold a policy that is not responding to a loss, and in the process failed to include the required disclosure to the client, a court can find the agent liable to his client without the usual requirement that the client prove that the agent acted negligently.

What are the applicable laws and regulations when selling policies where the risk involves multiple states? If an agent sells a policy to a fireworks manufacturer with factories and sales outlets in multiple states, which state's requirements does he need to follow? Which state's surplus lines taxes must be paid? Because the insurance law in each state may be different, this can be a complicated issue—so much so that legislation is pending in Congress to simplify the process (Nonadmitted and Reinsurance Reform Act of 2007). Until implementation of national standards for state regulation of surplus lines products, check with the applicable insurance regulators and the local surplus lines association for guidance.

Largely because of the unique issues involved with writing non-admitted coverage, most states require agents and brokers placing such coverage to have a surplus lines license in addition to their insurance license. For this reason, many agents with few E&S risks will work through a broker licensed to sell coverage with surplus lines carriers. It's good practice to confirm that the policy numbers the broker provides are legitimately issued by the carrier; there have been instances where brokers pocket premiums and issue false certificates of insurance or binders without having placed coverage.

The main focus of good surplus lines practices should be disclosure and documentation. Disclose to your customer everything the applicable regulations require in the manner prescribed by those regulations, most commonly with an emphasis on the lack of protection against carrier insolvency by a guarantee fund. Also, disclose all coverage restrictions the policy carries and document that discussion. Document that you have met all the prerequisites to place a risk in the surplus lines market.

Unfortunately, insurance written in the E&S market generates E&O claims just like in the standard lines market. In addition, claims from the E&S market have a few added twists. Because of the varied coverages afforded by E&S carriers vis-à-vis the standard lines market and sometimes each other, claims develop where the client is without coverage for a particular loss that a prior policy would have covered. Defense of these claims can be complicated when agents cannot show that they discussed the restricted breadth of coverage in the new policy and the resultant changes. If the agent does not have a surplus lines license or the carrier is not authorized to write in the state, the defense is even more challenging. 

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E&S Market

The excess & surplus lines market consists of U.S. and offshore carriers that sell insurance on non-admitted paper, which is not subject to the same regulatory scrutiny as standard lines carriers' policies. This allows E&S carriers to write specialized coverage that addresses unusual risks and write higher limits or reduced coverage for hazardous risks. Furthermore, E&S carriers have greater flexibility in setting rates, allowing them to enter markets unfeasible for a standard line carrier.

E&S carriers do not contribute to most states' guarantee funds and, thus, there is generally no protection from unpaid claims due to carrier insolvency. However, E&S carriers are usually admitted in their own state of domicile and are subject to at least one state's regulatory oversight. Further, reporting agencies such as A.M. Best and Standard & Poor's review a large number of E&S carriers. Finally, even though a carrier is "non-admitted," it must still be "authorized" to transact business in a particular state. Agents should gather as much information as possible and advise clients accordingly. Failure to advise of a carrier's rating, if less than ideal, could make it more difficult to defend an E&O claim based on that carrier's subsequent insolvency. Selling a policy from a carrier unauthorized to do business in your state could create serious issues.

Agencies that track policies by the billing entity may have to find a way to track by carrier as well, as policies billed by MGAs and other intermediaries would be more difficult to link back to the carrier.

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