Pitfalls of Placing Surplus Lines

Independent agents assume many responsibilities when placing surplus lines insurance in addition to the usual responsibilities of placing coverage in the admitted markets. Surplus lines insurance is insurance that is not offered in the admitted markets of a given state. The state's commissioner of insurance has very limited power to regulate the nonadmitted carriers, and policyholders are generally not protected by the state guarantee fund. Accordingly, surplus lines insurance is considered to be inferior and agents should only use it when coverage is not available in the admitted markets.

Since insurance commissioners have limited control over surplus lines carriers or their products, they exercise control over the agents who place such coverage. If there is a problem with a loss on a surplus lines policy, attention turns to the agent who placed the coverage. Mistakes made in the placement of the coverage can force the agent to step into the shoes of the surplus lines carrier and pay the otherwise uncovered loss. Thus, it is important to know the requirements of placing surplus lines insurance in every state in which you do business.

While each state has its own laws governing surplus lines coverage, certain basic requirements are almost always included. As already mentioned, surplus lines insurance should not be placed if an admitted product is available. While most new policies are placed with surplus lines as a last resort, agents must remember to shop the coverage on each renewal. The insurance industry is always changing, causing new markets to emerge. Surplus lines coverage should be moved to an admitted carrier when it becomes possible.

Next, make sure the surplus lines carrier is in sound financial condition and authorized to do business in the state (a different requirement than being "admitted"). Also, note that your E&O coverage may only cover claims where the underlying coverage is placed with a financially sound carrier. For example, the Westport policy marketed by Swiss Re requires a carrier to have a rating of B+ or higher at the time the coverage is placed, otherwise claims arising from the carrier's financial inability to pay might be excluded.

Probably the most common error leading to E&O claims arising out of a surplus lines carrier's inability to pay is the failure to have the policy properly stamped. Each state has its own requirement on the size, color, placement and wording of the stamp, but generally the stamp states that the policy is from a nonadmitted carrier, the policy is not subject to review or approval of the insurance commissioner and that the policy is not covered by the state guaranty fund. This stamp is usually placed either on the declarations page of the policy or added to the policy by endorsement. In cases where there is no stamp or the stamp does not conform to the state's requirement or even where the wrong state's surplus lines stamp is used, the failure of the agent to meet the stamp requirement will usually result in liability on the agent.

Finally, once you receive a copy of the surplus lines policy you should carefully review it. Surplus lines carriers don't have to use the same policy forms nor offer the same coverages as admitted carriers. Thus, you must take the time to review these policies to see what coverage is being afforded and make sure it meets your customer's needs.

Obtain the requirements for placing surplus lines coverage in each state in which your agency does business. Make sure you know which state's (or states') requirements to follow when placing coverage for an entity with multiple locations. Be sure to learn these requirements and remember the pitfalls of placing surplus lines insurance each time you place or renew such coverage. IA

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Don't Overlook Technicalities

Courts hold agents to every technical requirement in placing surplus lines coverage. For example, surplus lines insurance can only be placed through a properly licensed surplus lines broker. That broker is responsible to collect the applicable surplus lines tax as well as any stamping fee. Failure to follow the technical regulations can have dire consequences for agents. If the surplus lines tax is not paid properly the agent can be made to step into the shoes of an insolvent carrier, even though whether the tax was paid has no bearing on a surplus lines carrier's ability to pay a loss. There is also case law finding that a surplus lines broker, whose license had lapsed at the time of the placement, is responsible for an insolvent surplus lines carrier's liability.

—J.R.

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