

<b>Regulatory Analysis Form</b>		<b>This space for use by IRRC</b>
(1) Agency Insurance Department		<p>RECEIVED            03 02 1998 11:13            REGULATORY REVIEW COMMISSION  <b>Bush</b></p> <p>IRRC Number: 1988</p>
(2) I.D. Number (Governor's Office Use) 11-170		
(3) Short Title Surplus Lines Insurance		
(4) PA Code Cite 31 Pa. Code, Chapter 124	(5) Agency Contacts & Telephone Numbers Primary Contact: Peter J. Salvatore, Regulatory Coordinator, 1326 Strawberry Square, Harrisburg, PA 17120, (717) 787-4429 Secondary Contact: Elaine M Leitzel, Administrative Officer, Office of Regulation of Companies, 1345 Strawberry Square, Harrisburg, PA 17120 (717) 787-8840	
(6) Type of Rulemaking (check one) <input checked="" type="checkbox"/> Proposed Rulemaking <input type="checkbox"/> Final Order Adopting Regulation <input type="checkbox"/> Final Order, Proposed Rulemaking Omitted	(7) Is a 120-Day Emergency Certification Attached? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes: By the Attorney General <input type="checkbox"/> Yes: By the Governor	
(8) Briefly explain the regulation in clear and nontechnical language. <p>The surplus lines insurance market is intended to provide coverage for "non-standard" or unique risks that do not fit the underwriting guidelines of insurers licensed to conduct business in the traditional market (admitted insurers). Surplus lines insurance may be procured through licensed surplus lines agents (surplus lines licensees) from insurers that appear on a list of eligible surplus lines insurers published by the Department. The surplus lines licensee may be contacted by the consumer or by another insurance broker (producing broker) who is dealing directly with the consumer.</p> <p>Pennsylvania's surplus lines laws and regulations were adopted to establish a system of regulation that permits orderly access to surplus lines insurance in this Commonwealth with reputable and financially sound insurers and provides for adequate protections in the insurance marketplace. Pennsylvania's initial Surplus Lines Insurance Law (Act of January 24, 1966, 1965 P.L. 1509, No. 531) was replaced by Article XVI of the Insurance Company Law (the act)(40 P.S. §§991.1601 - 991.1625) in 1992. The purpose of this rulemaking is to replace the regulations adopted under the authority of the initial Surplus Lines Insurance Law with an updated regulation consistent with Article XVI of the act.</p>		
(9) State the statutory authority for the regulation and any relevant state or federal court decisions. <p>The regulation is proposed under the authority of Article XVI of the Insurance Company Law (40 P.S. §§991.1601 - 991.1625).</p>		

**Regulatory Analysis Form**

(10) Is the regulation mandated by any federal or state law or court order, or federal regulation? If yes, cite the specific law, case or regulation, and any deadlines for action.

No.

(11) Explain the compelling public interest that justifies the regulation. What is the problem it addresses?

This rulemaking is needed to implement Article XVI of the Insurance Company Law (40 P.S. §§ 991.1601 - 991.1625) enacted in 1992 and to enhance the efficiency of effectiveness of Pennsylvania's regulation of the surplus lines insurance market.

(12) State the public health, safety, environmental or general welfare risks associated with nonregulation.

There are no public health, safety, environmental or general welfare risks associated with this rulemaking.

(13) Describe who will benefit from the regulation. (Quantify the benefits as completely as possible and approximate the number of people who will benefit.)

Insurers and producers transacting surplus lines insurance in this Commonwealth will benefit by having clear standards for compliance with Article XVI of the act. Insurance consumers will benefit from the provisions for adequate notice, due process protections and requirements promoting the financial solvency of eligible surplus lines insurers. Insurers and producers doing business in the traditional (licensed) market will also benefit by the establishment of clear standards for the placement of risks in the surplus lines market. The regulation also serves to protect Commonwealth revenues by imposing bonding requirements on surplus lines licensees that are consistent with their obligations to remit premium taxes.

**Regulatory Analysis Form**

(14) Describe who will be adversely affected by the regulation. (Quantify the adverse effects as completely as possible and approximate the number of people who will be adversely affected.)

No adverse effects are anticipated as a result of this regulation.

(15) List the persons, groups or entities that will be required to comply with the regulation. (Approximate the number of people who will be required to comply.)

Surplus lines agents, producing brokers and surplus lines insurers transacting business in this Commonwealth will be required to comply with the regulation. 135 insurers are currently on the Department's list of eligible surplus lines insurers. 268 resident corporations or individuals are licensed as surplus lines agents, and 353 individuals have been granted certificates of eligibility to transact business for these licensees.

(16) Describe the communications with and input from the public in the development and drafting of the regulation. List the persons and/or groups who were involved, if applicable.

In drafting this regulation, the Department requested comments from the Pennsylvania Surplus Lines Association, surplus lines association in 12 other states, The Insurance Federation of Pennsylvania, Inc., the Professional Insurance Agents Association, the Independent Insurance Agents of Pennsylvania and a number of firms appointed as United States contacts for alien surplus lines insurers. The comments received in response to the Department's request were considered in the development of the proposed rulemaking.

(17) Provide a specific estimate of the costs and/or savings to the regulated community associated with compliance, including any legal, accounting or consulting procedures which may be required.

The reporting, recordkeeping and qualification requirements in the regulation will impose no significant costs on the regulated community. The regulation will result in savings to the regulated community by eliminating costs associated with the filing and review of binding authority contracts.

**Regulatory Analysis Form**

**(18) Provide a specific estimate of the costs and/or savings to local governments associated with compliance, including any legal, accounting or consulting procedures which may be required.**

There are no costs or savings to local governments associated with this rulemaking.

**(19) Provide a specific estimate of the costs and/or savings to state government associated with the implementation of the regulation, including any legal, accounting, or consulting procedures which may be required.**

The regulation eliminates the costs associated with the Department's review of binding authority contracts. The rulemaking serves to protect Commonwealth revenues by establishing adequate bonding requirements for agents who are responsible for remitting the 3% tax on surplus lines premiums.

**Regulatory Analysis Form**

(20) In the table below, provide an estimate of the fiscal savings and costs associated with implementation and compliance for the regulated community, local government, and state government for the current year and five subsequent years.

	<b>Current FY Year</b>	<b>FY +1 Year</b>	<b>FY +2 Year</b>	<b>FY +3 Year</b>	<b>FY +4 Year</b>	<b>FY +5 Year</b>
<b>SAVINGS:</b>	\$	\$	\$	\$	\$	\$
<b>Regulated Community</b>	\$800	\$800	\$800	\$800	\$800	\$800
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Savings</b>						
<b>COSTS:</b>						
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Costs</b>						
<b>REVENUE LOSSES:</b>						
<b>Regulated Community</b>						
<b>Local Government</b>						
<b>State Government</b>						
<b>Total Revenue Losses</b>						

(20a) Explain how the cost estimates listed above were derived.

The measurable savings to the regulated community result from the elimination of the \$65 filing fee for binding authority contracts. There are no other significant measurable costs or savings associated with the implementation of the regulation.

**Regulatory Analysis Form**

(20b) Provide the past three year expenditure history for programs affected by the regulation. N/A.

<b>Program</b>	<b>FY -3</b>	<b>FY -2</b>	<b>FY -1</b>	<b>Current FY</b>

(21) Using the cost-benefit information provided above, explain how the benefits of the regulation outweigh the adverse effects and costs.

No significant costs are anticipated to be imposed on affected parties as a result of the regulation. The regulation will eliminate current costs associated with the filing of binding authority contracts. The regulation will benefit the regulated community by providing guidance in efforts to comply with Article XVI of the act. The insurance industry and the general public will benefit to the extent that adoption of the regulation enhances the efficiency and effectiveness of Pennsylvania's regulation of the surplus lines insurance market and promotes the financial solvency of surplus lines insurers transacting business in this Commonwealth.

(22) Describe the nonregulatory alternatives considered and the costs associated with those alternatives. Provide the reasons for their dismissal.

This rulemaking is the most efficient method to implement Article XVI of the act.

(23) Describe alternative regulatory schemes considered and the costs associated with those schemes. Provide the reasons for their dismissal.

This rulemaking replaces two outdated regulations. No other regulatory schemes were considered.

**Regulatory Analysis Form**

**(24) Are there any provisions that are more stringent than federal standards? If yes, identify the specific provisions and the compelling Pennsylvania interest that demands stronger regulation.**

No.

**(25) How does this regulation compare with those of other states? Will the regulation put Pennsylvania at a competitive disadvantage with other states?**

In developing the regulation, the Department researched and considered surplus lines insurance requirements in a number of other states and solicited input from surplus lines advisory organizations in 12 states. The regulation will not put Pennsylvania at a competitive disadvantage with other states.

**(26) Will the regulation affect existing or proposed regulations of the promulgating agency or other state agencies? If yes, explain and provide specific citations.**

No.

**(27) Will any public hearings or informational meetings be scheduled? Please provide the dates, times, and locations, if available.**

No public hearings or informational meetings are anticipated.

**Regulatory Analysis Form**

**(28) Will the regulation change existing reporting, record keeping, or other paperwork requirements? Describe the changes and attach copies of forms or reports which will be required as a result of implementation, if available.**

The regulation will eliminate paperwork requirements associated with the filing of binding authority contracts. The regulation will update reporting requirements associated with a search of the licensed market and will impose recordkeeping requirements on brokers who conduct that search. The current forms filed by surplus lines agents and producing brokers when placing coverage in the surplus lines market under Article XVI of the act will not be changed as a result of implementation of the regulation.

**(29) Please list any special provisions which have been developed to meet the particular needs of affected groups or persons including, but not limited to, minorities, elderly, small businesses, and farmers.**

Section 124.5(a) of the regulation will permit a producing broker who has less than three agent appointments to obtain declinations of coverage from less than three licensed insurers before coverage is placed with an eligible surplus lines insurer. Section 124.5(a)(3) permits a producing broker to assume that a licensed insurer has declined to write a risk if the insurer fails to respond within five working days after first being contacted by the broker.

**(30) What is the anticipated effective date of the regulation; the date by which compliance with the regulation will be required; and the date by which any required permits, licenses or other approvals must be obtained?**

The regulation will take effect after a 30-day public comment period and upon final approval by the legislative standing committees, the Office of Attorney General and the Independent Regulatory Review Commission.

**(31) Provide the schedule for continual review of the regulation.**

All Department regulations are reviewed for continued effectiveness on a triennial basis.



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FACE SHEET  
FOR FILING DOCUMENTS  
WITH THE LEGISLATIVE REFERENCE  
BUREAU

(Pursuant to Commonwealth Documents Law)

UNCLASIFIED

LEGISLATIVE REFERENCE BUREAU  
HARRISBURG, PENNSYLVANIA

DO NOT WRITE IN THIS SPACE

Copy below is hereby approved as to  
form and legality. Attorney General

*Robert J. Shapiro*  
\_\_\_\_\_  
(Deputy Attorney General)

SEP 22 1998

Date of Approval

→ Check if applicable.  
Copy not approved. Objections  
attached.

Copy below is hereby certified to be a true and correct  
copy of a document issued, prescribed or promulgated  
by:

Insurance Department

(AGENCY)

DOCUMENT/FISCAL NOTE NO. 11-170

DATE OF ADOPTION: \_\_\_\_\_

BY: *M. Diane Koken*  
\_\_\_\_\_  
M. Diane Koken

Insurance Commissioner

TITLE: \_\_\_\_\_  
(EXECUTIVE OFFICER, CHAIRMAN OR  
SECRETARY)

Copy below is hereby approved as to form and  
legality. Executive or Independent Agencies

BY: *Tom F. Weabey*  
\_\_\_\_\_

9/10/98  
DATE OF APPROVAL

(DEPUTY GENERAL COUNSEL)  
~~(CHIEF COUNSEL, INDEPENDENT AGENCY)~~  
(STRIKE INAPPLICABLE TITLE)

→ Check if applicable. No Attorney General  
approval or objection within 30 days after  
submission.

NOTICE OF PROPOSED RULEMAKING

INSURANCE DEPARTMENT

31 Pa. Code, Chapter 124, Sections 124.1-124.10  
31 Pa. Code, Chapter 123, Sections 123.1-123.63 and Exhibit D  
31 Pa. Code, Chapter 35, Sections 35.1-35.22

SURPLUS LINES INSURANCE

## PREAMBLE

The Insurance Department (Department) proposes to amend 31 Pa. Code by rescinding Chapter 35 (relating to surplus lines agents) and Chapter 123 (relating to surplus lines) and adopting Chapter 124 (relating to surplus lines insurance) to read as set forth in Annex A. The regulation is proposed under the authority of Article XVI of the Insurance Company Law (the act) (40 P.S. §§ 991.1601 - 991.1625). The regulation sets forth duties and requirements relating to surplus lines agents, producing brokers and surplus lines insurers transacting business in this Commonwealth.

### *Purpose*

The surplus lines insurance market is intended to provide coverage for "non-standard" or unique risks that do not fit the underwriting guidelines of insurers licensed to transact business in the market for standard or traditional insurance coverages (admitted insurers). Surplus lines insurance may be procured through licensed surplus lines agents (surplus lines licensees) from insurers that appear on a list of eligible surplus lines insurers published by the Department. A surplus lines licensee may place coverage as a result of being contacted directly by a consumer or in response to a request from another insurance broker (producing broker) who is dealing directly with the consumer.

Pennsylvania's surplus lines laws and regulations were adopted to establish a system of regulation that permits orderly access to surplus lines insurance in this Commonwealth with reputable and financially sound insurers and provides for adequate protections in the insurance marketplace. Pennsylvania's initial Surplus Lines Insurance Law (Act of January 24, 1966, 1965 P.L. 1509, No. 531) was replaced by Article XVI of the act in 1992. The purpose of this rulemaking is to replace the regulations adopted under the authority of the initial Surplus Lines Insurance Law with an updated regulation consistent with Article XVI of the act.

### *Explanation of Regulatory Requirements*

Section 124.1 (relating to definitions) defines key terms used to identify the types of insurers that fall within the scope of the regulation and other terms needed to supplement the definitions in section 1602 of the act (40 P.S. § 991.1602). The definitions clarify terms used in the regulation without unnecessary duplication of definitions in the act.

Section 1608 of the act (40 P.S. § 991.1608) requires that insureds be given written notice when all or part of their insurance is placed with a nonadmitted insurer (an eligible surplus lines insurer or other insurer that is not authorized and not licensed to do business in this Commonwealth). The notice

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must be provided at the time an insured is presented with a quotation and must advise the insured that (1) the nonadmitted insurer is not licensed by the Department and is subject to only limited regulation; and (2) losses will not be covered by the state guaranty fund in the event the insurer becomes insolvent. Section 124.2 (relating to notice to insured) of the regulation requires that the notice be substantially similar in content to that set forth in section 1608 and prominently printed on the first page of the quotation. These provisions are intended to assure that this important information is clearly and accurately conveyed to consumers before they purchase surplus lines insurance.

Section 1618 of the act (40 P.S. § 991.1618) specifically provides that a surplus lines licensee who is granted binding or underwriting authority by an eligible surplus lines insurer is subject to regulations promulgated by the Department. Subsection 124.3(a) (relating to conditions of binding authority) of the regulation prohibits a surplus lines licensee from exercising binding authority without a properly executed written contract with the eligible surplus lines insurer that sets forth the terms, conditions and limitations of the surplus lines licensee's binding authority. In addition, subsection 124.3(a) lists the minimum provisions required in binding authority contracts. These minimum requirements are intended to assure that a contract clearly defines the limits of the surplus lines licensee's authority and either expressly prohibits the licensee from delegating that authority or, if the contract permits delegation, requires the licensee to obtain the insurer's written approval prior to delegating binding authority. Subsections 124.4(b) and (c) require that executed copies of the contracts or any instruments delegating authority granted under the contracts be maintained in this Commonwealth and available for examination by the Department for at least five years following termination. These retention requirements provide the Department with the access needed to determine compliance with the regulation.

Subsection 1612(a) of the act (40 P.S. § 991.1612(a)) requires the surplus lines licensee to deliver the insurance contract to the insured or the producing broker upon placing surplus lines insurance. If the insurance contract is not immediately available, the licensee may deliver a cover note, binder or other evidence of insurance that contains at least the information required in subsection 1612(a). Section 124.4 (relating to evidence of insurance) of the regulation requires the surplus lines licensee to deliver the contract or other evidence of insurance no later than 15 calendar days after either binding the coverage or receiving notice from the insurer that it has assumed the risk. The 15-day requirement establishes a clearly defined time frame for delivery of the contract or other evidence of insurance under section 1612 of the act.

Subsection 124.4(c) of the regulation requires the contract or other evidence of insurance to contain a service of process

clause with language substantially similar to the language in that subsection. The clause is intended to facilitate compliance with section 1624 of the act (40 P.S. § 991.1624) providing for service of process in actions against surplus lines insurers. Specifically, section 1624(a) requires the contract or other evidence of insurance to contain a provision stating the substance of that section and designating the person on whom process shall be served.

Section 1604(2) of the act (40 P.S. § 991.1604(2)) sets forth three criteria, at least one of which must be satisfied before a surplus lines licensee may place coverage with an eligible surplus lines insurer. Section 1604(2)(i), the first criterion, permits placement of surplus lines insurance when the full amount or kind of insurance cannot be obtained from admitted insurers, if a diligent search has been made among the admitted insurers who are writing, in this Commonwealth, coverage comparable to the coverage being sought. Section 124.5 (relating to diligent search of admitted insurers) of the regulation establishes the minimum duties and requirements that apply to producing brokers and surplus lines licensees in conducting a diligent search of the licensed market.

Current declaration forms required under section 1609(a)(1)(i) of the Act (40 P.S. § 991.1609(a)(1)(i)) to be executed by the producing broker (or by the surplus lines licensee when acting as the producing broker) require the producing broker to identify at least three admitted insurers which have declined to insure the risk. Section 124.5(a)(1) of the regulation will permit a producing broker who has less than three agent appointments to obtain declinations from less than three admitted insurers. While brokers may be appointed by admitted insurers to act as agents, they are not required to maintain appointments. The provisions for less than three declinations have been included in the regulation to recognize that a producing broker with less than three agent appointments may not be able to obtain at least three declinations. In addition, section 124.5(a)(5) permits a producing broker to assume that an admitted insurer has declined a risk if the insurer fails to respond within five business days of the broker's request.

Section 124.5(a)(3) requires the producing broker to create a written record of a declination of coverage, either by obtaining a written declination from the insurer or creating a written record to document an oral declination. Section 124.5(a)(4) lists the information required to be included in a written record created to document an oral declination. This documentation is an important part of the record of insurance contracts placed in the surplus lines market under section 1609(a)(1)(i) of the act.

Section 124.5(b) refers to the statutory duties imposed on surplus lines licensees in the conduct of a diligent search of

the licensed market. Specifically, the licensee is required to file a written declaration of the licensee's lack of knowledge of how the coverage could have been procured from admitted insurers. In addition, if a surplus lines licensee acts as both the producing broker and the surplus lines licensee, the licensee must also execute the declaration form applicable to the producing broker. These references have been included in the regulation to integrate and clarify the various statutory duties related to a diligent search of admitted insurers when coverage is placed in the surplus lines market under section 1604(2)(i) of the Act (40 P.S. § 991.1604(2)(i)).

Section 124.5(c) establishes qualification requirements for persons authorized to decline coverage on behalf of admitted insurers. The person must be a full-time employee of the admitted insurer with underwriting responsibility or a full-time employee of an underwriting manager for the insurer. In addition, section 124.5(d) prohibits declinations from being obtained from an affiliate of an admitted insurer that has already declined the risk and also prohibits surplus lines insurance from being placed with an affiliate of a declining insurer, except when the affiliated insurers are independent of each other as defined in section 124.5(d)(3). These restrictions are needed to assure that a proper diligent search is made of the admitted market before coverage is placed in the surplus lines market under the criterion in section 1609(a)(1)(i) of the act.

Section 1604(2)(ii) of the act (40 P. S. § 991.1604(2)(ii)) permits coverage to be placed in the surplus lines market if no admitted insurers are writing coverage comparable to the coverage being sought. Under this second criterion for placement of surplus lines insurance, the Insurance Commissioner has published an export list of the coverages declared to be generally unavailable in the admitted market. (See 27 Pa.B. 2795 (June 7, 1997)) Section 124.6 (relating to export list coverages) of the regulation clarifies that the diligent search requirement in section 1604(2)(i) and related reporting requirements do not apply to the placement of coverage that appears on the export list. Within 45 days of placing coverage that appears on the export list, section 124.6(c) requires the surplus lines licensee to file a copy of the declaration page of the policy or other evidence of insurance with the Department.

Section 1604(2)(iii) of the act (40 P.S. § 991.1604(2)(iii)), the third criterion under which coverage may be placed in the surplus lines market, permits coverage to be placed in the surplus lines market if it is a unique form of coverage not available in the admitted market. Section 124.7 (relating to unique forms of coverages) of the regulation requires the surplus lines licensee to file a declaration reporting these transactions in a form prescribed by the Department within 45 days of placing the coverage. The filing requirements relating to export list and unique forms of coverage will allow the Department to monitor the placement of these coverages in the surplus lines market.

Section 1615(b)(4) of the act (40 P.S. § 991.1615(b)(4)) requires a surplus lines licensee to file with the Department and maintain a surety bond in the amount of at least \$50,000. The bond is to be conditioned that the surplus lines licensee will conduct business in accordance with the provisions of Article XVI of the act and will promptly remit the taxes as provided by law. Section 1621 of the act (40 P.S. § 991.1621) imposes a 3% tax on all premiums charged for insurance placed with an eligible surplus lines insurer or other nonadmitted insurer. The surplus lines licensee is responsible for the collection of the 3% tax from the insured or the producing broker at the time of delivery of the initial contract or other evidence of insurance. On or before January 31 each year, the surplus lines licensee is required to file a report of all transactions during the previous calendar year with the tax due for those transactions. Section 124.8(a) (relating to surplus lines licensee bond requirements) of the regulation requires a bond in the amount of at least \$50,000 for the initial term of a license. Section 124.8(b) requires the amount of the bond for renewal of a license to be based on the total amount of the licensee's taxable surplus lines premiums for the preceding calendar year, as determined by a table set forth in section 124.8(b). These requirements are needed to assure that the required minimum amount of a licensee's bond is commensurate with the licensee's obligation to remit the 3% premium tax.

Section 124.9 (relating to requirements to qualify as an eligible surplus lines insurer) sets forth requirements that insurers must meet to be considered under section 1605(b) of the act (40 P.S. § 991.1605(b)) for placement on the Department's list of eligible surplus lines insurers. In addition to the requirements of Article XVI of the act, the insurer must be licensed in its domiciliary jurisdiction to transact the kinds of insurance it proposes to provide in this Commonwealth. The insurer also must have been engaged in transacting surplus lines insurance in at least one jurisdiction, or have been an affiliate of an admitted insurer, for the three years immediately preceding the insurer's application for inclusion on the Department's list. Under section 1605(a)(2)(i) of the act (40 P.S. § 991.1605(a)(2)(i)) an alien insurer is required to maintain an irrevocable trust fund in the United States in an amount not less than currently required by the National Association of Insurance Commissioners (NAIC) for the protection of all policyholders in the United States. Section 124.9(3) requires alien insurers to provide evidence of their inclusion on the list of alien insurers that have met the NAIC's criteria. The qualifications in the regulation are consistent with the eligibility requirements in section 1605 of the act and assure that insurers transacting surplus lines business in this Commonwealth are reputable and financially sound.

Section 124.10 (relating to eligible surplus lines insurer filing requirements) lists the information that must be included

in applications by foreign and alien insurers for consideration for inclusion on the Department's list of eligible surplus lines insurers. After placement on the Department's list, the insurers are required to provide the Department with any updates to the information within the time frames provided in sections 124.10(b) and (d). The information required in this section will enable the Department to assess the financial condition of applicants and determine whether the applicants satisfy the requirements of Article XVI and the regulation, including the trust fund requirements applicable to alien insurers.

#### *External Comments*

In drafting this updated regulation, the Department requested comments from the Pennsylvania Surplus Lines Association, surplus lines associations in 12 other states, The Insurance Federation of Pennsylvania, Inc., the Professional Insurance Agents Association, the Independent Insurance Agents of Pennsylvania and a number of firms appointed as United States contacts for alien surplus lines insurers. The comments received in response to the Department's request were considered in the development of this proposed rulemaking.

#### *Fiscal Impact*

The reporting, recordkeeping and qualification requirements in this regulation will impose no significant costs on surplus lines licensees, producing brokers or surplus lines insurers transacting business in this Commonwealth. Department costs associated with the review of applications and reports filed under the regulation will not increase as a result of this regulation. The regulation will have a beneficial fiscal impact by eliminating current costs imposed on regulated parties and the Department related to the filing and review of binding authority contracts. The regulation serves to enhance the protection of Commonwealth revenues by imposing minimum bonding requirements consistent with premium tax liability. The regulation has no impact on costs to political subdivisions. While the regulation has no immediate fiscal impact on the general public, the general public will benefit to the extent that adoption of the regulation enhances the efficiency and effectiveness of Pennsylvania's regulation of surplus lines insurance under Article XVI of the act.

#### *Paperwork*

The regulation eliminates filing requirements related to binding authority contracts. The regulation requires producing brokers to maintain records to demonstrate that a diligent search of licensed insurers was made before coverage is placed in the surplus lines market. These recordkeeping requirements provide guidance to producing brokers in efforts to conduct a proper search of the licensed market and enhance compliance with the statutory conditions that must be met before coverage is placed

in the surplus lines market. The requirements also enhance the Department's ability to monitor transactions in the surplus lines market.

#### *Persons Regulated*

This regulation applies to all surplus lines agents, producing brokers and surplus lines insurers transacting business in this Commonwealth.

#### *Contact Person*

Questions or comments regarding this proposed rulemaking may be addressed in writing to Peter J. Salvatore, Regulatory Coordinator, Office of Special Projects, 1326 Strawberry Square, Harrisburg, Pennsylvania 17120, telephone number (717) 787-4429, within 30 days following the publication of this notice in the *Pennsylvania Bulletin*.

#### *Regulatory Review*

Under Section 5(a) of the Regulatory Review Act, Act 24 of June 25, 1997, the agency submitted a copy of these proposed amendments on SEPTEMBER 23, 1998 to the Independent Regulatory Review Commission (the Commission) and to the Chairpersons of the House Committee on Insurance and the Senate Committee on Banking and Insurance. In addition to submitting these proposed amendments, the agency has provided the Commission and the Committees with a copy of a detailed Regulatory Analysis Form prepared by the agency in compliance with Executive Order 1996-1. A copy of this material is available to the public upon request.

If the Commission has any objections to any portion of the proposed amendments, it will notify the agency within 30 days after the close of the public comment period. The notification shall specify the regulatory review criteria which have not been met by that portion. The Act specifies detailed procedures for review, prior to final publication of the regulations by the agency, the General Assembly and the Governor of objections raised.

M. Diane Koken  
Insurance Commissioner



CONTINUATION SHEET FOR FILING DOCUMENTS  
WITH THE LEGISLATIVE REFERENCE BUREAU  
Pursuant to Commonwealth Documents Law

ANNEX A

Title 31. Insurance, Part VIII. Miscellaneous Provisions, Chapter  
124. Surplus Lines Insurance.

Sections

- 124.1. Definitions.
- 124.2. Notice to Insured.
- 124.3. Conditions of Binding Authority.
- 124.4. Evidence of Insurance.
- 124.5. Diligent Search of Admitted Insurers.
- 124.6. Export List Coverages.
- 124.7. Unique Forms of Coverages.
- 124.8. Surplus Lines Licensee Bond Requirements.
- 124.9. Requirements to Qualify as an Eligible Surplus  
Lines Insurer.
- 124.10. Eligible Surplus Lines Insurer Filing Requirements.
  
- 124.1. Definitions.

The following words and terms, when used in this chapter, shall  
have the following meanings unless the context clearly indicates  
otherwise:

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Act - Article XVI of the Insurance Company Law, Act of May 17, 1921, P.L. 682, No. 284, as amended, (40 P.S. §§ 991.1601-991.1625).

Alien insurer - An insurer incorporated or organized under the laws of a foreign nation or of a province or territory other than a state or a territory of the United States or the District of Columbia.

Binding authority - The authority delegated to a surplus lines licensee by an eligible surplus lines insurer to obligate the eligible surplus lines insurer to accept a particular risk.

Eligible surplus lines insurer list - The most recent list of eligible surplus lines insurers published by the Department under section 1605(b) of the Act (40 P.S. § 991.1605(b)).

Foreign insurer - An insurer, other than an alien insurer, not incorporated or organized under the laws of the Commonwealth. For purposes of this chapter, the term also includes a United States branch of an alien insurer which branch is not entered through and licensed to transact insurance or reinsurance in this Commonwealth.

Unless the context otherwise requires, other terms found in this chapter are used as defined in the Act.

124.2. Notice to insured.

The written notice required to be given to the insured under section 1608 of the Act (40 P.S. § 991.1608) shall be:

(1) substantially similar in content to that set forth in section 1608(1) and (2).

(2) prominently printed on the first page of the quotation.

124.3. Conditions of binding authority.

(a) A surplus lines licensee may not exercise binding authority in this Commonwealth on behalf of an eligible surplus lines insurer unless there is in force a written contract executed by all parties to the contract setting forth the terms, conditions, and limitations governing the exercise of binding authority by the surplus lines licensee. The written contract shall, at a minimum, contain the following:

(1) A description of the classes of insurance for which the surplus lines licensee holds binding authority.

(2) The geographical limits of the binding authority.

(3) The maximum dollar limitations on the binding authority for any one risk for each class of insurance.

(4) The maximum policy period for which the surplus lines licensee may bind a risk.

(5) A prohibition against delegation of binding authority by the surplus lines licensee or, if the binding authority is delegable by the surplus lines licensee, a prohibition against delegation of binding authority by the surplus lines licensee without the prior written approval of the eligible surplus lines insurer.

(6) A provision in the following or substantially similar language.

It is understood and agreed that all insurance placed pursuant to this agreement on risks resident, located, or to be performed in this Commonwealth, shall be

effected and written in accordance with Article XVI of the Act of May 17, 1921, P.L. 682, No. 284 (40 P.S. Section 991.1601 - 991.1625).

(b) An executed copy of the written contract shall be maintained by the surplus lines licensee in its office in this Commonwealth. The copy shall be available at all reasonable times to examination by the Department without notice for a period of not less than five years following termination of the contract.

(c) If a surplus lines licensee, who is qualified under this chapter to exercise binding authority on behalf of the eligible surplus lines insurer, delegates binding authority to any other surplus lines licensee, the instrument delegating binding authority shall specifically identify the binding authority agreement between the delegating surplus lines licensee and the eligible surplus lines insurer. An executed copy of the instrument delegating binding authority shall be maintained by both the surplus lines licensee delegating binding authority and the surplus lines licensee to whom the authority is delegated in their offices in this Commonwealth. The copy shall be available at all reasonable times to examination by the Department without notice for a period of not less than five years following termination of the contract.

124.4. Evidence of insurance.

(a) Section 1612 of the Act (40 P.S. § 991.1612) requires the surplus lines licensee, upon placing surplus lines insurance, to deliver the contract of insurance to the insured or to the producing broker. A cover note, binder or other evidence of insurance shall be delivered by the surplus lines licensee if the contract of insurance is not immediately available.

(b) Delivery of the contract or other evidence of insurance by the surplus lines licensee shall occur:

(1) No later than 15 calendar days after coverage has been bound by the surplus lines licensee, if the surplus lines licensee holds binding authority on behalf of the eligible surplus lines insurer.

(2) No later than 15 calendar days after the surplus lines licensee has received written notification from the eligible surplus lines insurer or other nonadmitted insurer that it has assumed the risk, if the surplus lines licensee does not hold binding authority on behalf of the eligible surplus lines insurer.

(c) Under section 1624 of the Act (40 P.S. § 991.1624) a contract or other evidence of insurance delivered by the surplus lines licensee shall contain a service of process clause substantially similar to the following:

#### SERVICE OF PROCESS CLAUSE

It is agreed that in the event of the failure of the Insurer(s) or Underwriter(s) herein to pay any amount claimed to be due hereunder, the Insurer(s) or Underwriter(s) herein, at the request of the Insured (or reinsured), will submit to the jurisdiction of any court of competent jurisdiction within the United States of America and will comply with all requirements necessary to give such court jurisdiction, and all matters arising hereunder shall be determined in accordance with the law and practice of such court. It is further agreed that in any such action instituted against any one of them upon this contract, Insurer(s) or Underwriter(s) will abide by the final decision of such court or of any appellate court in the event of an appeal.

Service of process shall be made pursuant to the procedures provided by 42 Pa.C.S. Ch. 53 Subch. B (relating to interstate and international procedure). When making service of process by mail, such process shall be mailed to

\_\_\_\_\_ . The above-named is authorized and directed to accept service of process on behalf of the Insured(s) or Underwriter(s) in any such action or upon the request of the insured (or reinsured) to give a written undertaking to the insured (or reinsured) that it or they will enter a general appearance for the Insurer(s) or Underwriter(s) in the event such an action shall be instituted.

Further, pursuant to any statute of any state, territory or district of the United States of America, which makes provisions therefor, the Insured(s) or Underwriter(s) hereby designates the Superintendent, Commissioner or Director of Insurance or other officer specified for that purpose in the statute or his successor or successors in office, as the true and lawful attorney upon whom any lawful process may be served in any action, suit or proceeding instituted by or on behalf of the insured (or reinsured) or any beneficiary hereunder arising out of his contract of insurance (or reinsurance), and hereby



designates the above-named as the person on whom such process or a true copy thereof shall be served.

124.5. Diligent search of admitted insurers.

Under section 1604(2)(i) of the Act (40 P.S. § 991.1604(2)(i)), surplus lines insurance may be procured through a surplus lines licensee from nonadmitted insurers if a diligent search is made among the admitted insurers who are writing, in this Commonwealth, coverage comparable to the coverage being sought. The following minimum requirements and conditions apply to the conduct of a diligent search among admitted insurers under section 1604(2)(i) of the Act.

(a) Under section 1609(a)(1)(i) of the Act (40 P.S. § 991.1609(a)(1)(i)), the producing broker must execute and forward to the surplus lines licensee a written statement, in a form prescribed by the Department, declaring that a diligent effort to procure the desired coverage from admitted insurers was made.

(1) At a minimum, the producing broker shall obtain declinations from admitted insurers with which the producing broker holds agent appointments and which are writing, in this Commonwealth,

coverage comparable to the coverage being sought in accordance with the following table:

<u>Number of Agent Appointments</u>	<u>Number of Required Declinations</u>
0	1
1	1
2	2
3 or more	3

(2) A producing broker who obtains less than three declinations shall attach a notarized statement, affirming the number of agent appointments held, to the declaration form required under section 1609(a) of the Act (40 P.S. § 991.1609(a)).

(3) A producing broker who obtains a declination from an admitted insurer shall either obtain the declination in writing from the admitted insurer or create a written record of an oral declination by the admitted insurer. A written record of an oral declination shall be made by the person who initially received the declination or by another person working for the business from information transmitted by the person who received the declination. A declination shall be obtained from the admitted insurer or recorded

by the producing broker at or near the time of receipt of the declination and maintained in the regular course of business.

(4) A written record documenting an oral declination shall include:

(i) The name, office location and phone number of the admitted insurer or firm acting in the capacity of underwriting manager for the admitted insurer.

(ii) The name and position of the person contacted.

(iii) The date of contact.

(iv) An explanation of the declination.

(5) If an admitted insurer fails to respond within five business days after first being contacted by the producing broker, the producing broker may assume that the insurer has declined to write the risk. The producing broker shall create a written record of the contact, including the manner in which contact was made and the information required under subsection (4)(i) - (iii).

(b) Under section 1609(a)(2) of the Act (40 P.S. § 991.1609(a)(2)), the surplus lines licensee shall file with the Department a written declaration of the licensee's lack of knowledge of how the coverage could have been procured from admitted insurers and shall simultaneously file the written declaration of the producing broker required under section 1609(a)(1) of the Act (40 P.S. § 991.1609(a)(1)). Under section 1609(a)(3) of the Act (40 P.S. § 991.1609(a)(3)), if the surplus lines licensee acts as both the producing broker and surplus lines licensee in a particular transaction, the surplus lines licensee is required to execute the declarations required under sections 1609(a)(1) and (2) of the Act.

(c) A declination of coverage by an admitted insurer shall be made by a person who is a full-time employee of the admitted insurer and who has underwriting responsibility for that admitted insurer or by a full-time employee of a firm acting in the capacity of underwriting manager for the admitted insurer.

(d) For purposes of this paragraph, the term "affiliate" is used as defined in section 1401 of the Insurance Company Law of 1921 (40 P.S. § 991.1401).

(1) A declination may not be obtained from an admitted insurer which is an affiliate of an admitted insurer from which a declination has already been obtained.

(2) Surplus lines insurance may not be placed with a nonadmitted insurer that is an affiliate of an admitted insurer from which a declination has been obtained.

(3) The restrictions set forth in subparagraphs (1) and (2) shall not apply if the affiliated insurers write independently of each other using separate and independently developed underwriting criteria and marketing plans, and for underwriting purposes, compete with each other for the same type of coverage or class of insurance.

124.6. Export list coverages.

(a) Under section 1604(2)(ii) of the Act (40 P.S. § 991.1604(2)(ii)), the Commissioner may create and maintain an export list of insurance coverages for which the full amount or kind of insurance cannot be obtained from admitted insurers.

(b) The diligent search requirement of Section 1604(2)(i) of the Act (40 P.S. § 991.1604(2)(i)) and the reporting requirements of

Section 1609(a) of the Act (40 P.S. § 991.1609(a)) do not apply to the placement of an insurance coverage which appears on the export list.

(c) Within 45 calendar days after the placement of an insurance coverage which appears on the most recent export list published by the Commissioner, the surplus lines licensee shall file with the Department or its designee a copy of the declaration page of the policy, cover note, binder or other evidence of insurance delivered by the surplus lines licensee in accordance with section 1612(a) of the Act (40 P.S. § 991.1612(a)) with the word "EXPORT" stamped in red letters in the upper right hand corner.

124.7. Unique forms of coverages.

Under section 1604(2)(iii) of the Act (40 P.S. § 1604(2)(iii)), surplus lines insurance may be procured through a surplus lines licensee from nonadmitted insurers if the kind of insurance sought to be obtained from admitted insurers requires a unique form of coverage not available in the admitted market. Within 45 calendar days after a unique form of coverage has been placed, the surplus lines licensee shall file with the Department or its designee a written declaration reporting the transaction in a form prescribed by the Department.

124.8. Surplus lines licensee bond requirements.

(a) The bond required under section 1615(b)(4) of the Act (40 P.S. § 991.1615(b)(4)) to be maintained concurrent with the term of a surplus lines agent's license shall be in the amount of at least \$50,000 for the initial term of the license.

(b) The amount of the bond required for renewal of a surplus lines agent's license shall be based on the total taxable surplus lines premium volume of the surplus lines agent during the preceding calendar year as reported to the Department of Revenue under section 1621 of the Act (40 P.S. § 991.1621) and determined by using the following table:

Total Taxable Surplus	Required Minimum
<u>Lines Premium Volume</u>	<u>Amount of Bond</u>
\$0 - \$1,999,999	\$50,000
\$2,000,000 - \$3,999,999	\$100,000
\$4,000,000 - \$5,999,999	\$150,000
\$6,000,000 - \$7,999,999	\$200,000
\$8,000,000 - and over	3% of the total taxable surplus lines premium volume of the surplus lines licensee during the preceding calendar year or other amount acceptable to the Commissioner.

124.9. Requirements to qualify as an eligible surplus lines insurer.

(a) In order to be considered for placement on the most recent eligible surplus lines insurer list, a nonadmitted insurer shall meet the requirements of the Act and this chapter. The nonadmitted insurer shall:



(1) Be currently licensed as an insurer in the state or country of its domicile for the kind or kinds of insurance which it proposes to provide in this Commonwealth; and

(2) Have been either engaged in doing the business of surplus lines insurance in one or more jurisdictions for a period of not less than three full years immediately preceding the filing of an application to be an eligible surplus lines insurer; or be an affiliate of an admitted insurer which has been so admitted for a period of not less than three full years immediately preceding seeking approval to do business in this Commonwealth.

(b) In addition to the requirements in subsection (a), an alien insurer shall provide documentation evidencing its inclusion on the most recent quarterly listing of nonadmitted alien insurers which have met the criteria in the plan of operation adopted by the National Association of Insurance Commissioners International Insurers Department, or successor organization.

124.10. Eligible surplus lines insurer filing requirements.

(a) A request to consider a foreign nonadmitted insurer for placement on the Department's eligible surplus lines insurer list shall be made in writing by a surplus lines licensee and shall include the following:

(1) Charter. A copy of the charter of the nonadmitted insurer or similar document and any amendments, additions, and deletions thereto certified by the corporate secretary of the nonadmitted insurer.

(2) Certificate of authority. A copy of the certificate of authority of the insurer or similar document setting forth its authority to issue policies and insure risks in the jurisdiction in which the insurer is incorporated, formed or organized.

(3) Financial statement.

(i) A copy of the latest annual financial report or statement of the insurer signed by the officers of the insurer and filed with the insurance regulatory authority or other governmental authority in the jurisdiction in which the insurer is incorporated, formed or

organized. The copy shall include all supplemental reports, exhibits and schedules required as part of the annual statement filing and shall be certified as provided under section 1605(3) of the Act (40 P.S. § 991.1605(3)).

(ii) A copy of each subsequent quarterly financial report or statement of the insurer signed by the officers of the insurer and filed with the insurance regulatory authority or other governmental authority in the jurisdiction in which the insurer is incorporated, formed or organized.

(4) Report of examination. A copy of the most recent report of examination of the insurer conducted by the insurance regulatory authority or similar governmental authority requiring the examination and certified by the proper official of that authority.

(5) Biographical information. Biographical data for each officer, director, person in managerial control, and like individual on a form provided by the Department.

(6) Kind of insurance. A written statement by an officer of the insurer identifying the kinds of insurance coverages the insurer intends to write and the types of risks the insurer intends to insure in this Commonwealth.

(7) Designee for service of process. A written designation of the name of the individual employed by the insurer or other appropriate representative to whom all lawful process shall be mailed. The designee must maintain a legal residence, domicile or office in the United States.

(8) Additional information as may be required by the Commissioner to determine whether the insurer meets the standards and requirements of the Act and this chapter.

(b) After placement on the eligible surplus lines insurer list, a foreign insurer shall submit to the Department through a surplus lines licensee:

(1) Changes or additions, or both, to the information in subsection (a) (7) within 10 calendar days of the occurrence.

(2) Changes or additions, or both, to the information in subsections (a) (1) and (5) within 30 calendar days of the occurrence.

(3) A certified copy of the information in subsection (a) (3) (i) within 30 calendar days after the date required for filing

in its domiciliary jurisdiction. A copy of the information in subsection (a)(2) shall accompany the filing.

(4) A copy of the information in subsection (a)(3)(ii) within 45 calendar days from the close of the quarter for which the report is prepared.

(5) A certified copy of the information in subsection (a)(4) within 30 calendar days of the date it became a public document.

(6) Additional items as may be required by the Commissioner to determine whether the insurer continues to meet the standards under the Act.

(c) A request to consider an alien nonadmitted insurer for placement on the Department's eligible surplus lines insurer list shall be made in writing by a surplus lines licensee and shall include the following:

(1) Charter. A copy of the charter of the insurer or similar document and any amendments, additions, and deletions thereto certified by the corporate secretary of the insurer.

(2) Certificate of authority. A copy of the certificate of authority of the insurer or similar document setting forth its authority to issue policies and insurer risks in the jurisdiction in which the insurer is incorporated, formed or organized.

(3) Annual financial statement.

(i) Two copies of the latest annual financial report of the insurer signed by the officers of the insurer and filed with the insurance regulatory authority or other governmental authority in the jurisdiction in which the insurer is incorporated, formed or organized. One copy of the financial report or statement shall be expressed in language and currency of the place of incorporation, formation or organization of the insurer and the other copy prepared and expressed in the English language and United States currency at the current rate of exchange as of the statement date. Certification of the financial report or statement shall be in accordance with section 1605(3) of the Act (40 P.S. § 991.1605(3)).

(ii) A copy of the latest annual financial statement of the insurer in the standard reporting format prescribed by the National Association of Insurance Commissioners' International Insurers Department, or successor organization.

(4) Trust fund agreement.

(i) A copy of the trust fund agreement concerning the trust fund which the insurer maintains in the United States in either a national bank or a member of the Federal Reserve System in an amount as set out in the Act for the protection of all of its policyholders in the United States, consisting of cash, securities, letters of credit or investments of substantially the same character and quality as those which are eligible investments for admitted insurers authorized to write like kinds of insurance in this Commonwealth.

(ii) The trustees of the trust fund shall give written verification of the amount initially deposited and presently on deposit by the insurer in the trust fund. The trustees shall immediately give written notification to the Department at any time the trust fund deposit is less than the minimum requirement as provided for in section 1605(a)(2)(i) of the Act (40 P.S. § 991.1605(a)(2)(i)).

(5) Biographical sketches. Biographical data for each officer, director, person in managerial control, and like individual on a form provided by the Department.

(6) Kind of insurance. A written statement by an officer of the insurer identifying the kinds of insurance coverages the insurer intends to write and the types of risks the insurer intends to insure in this Commonwealth.

(7) Designee for service of process. A written designation of the name of the individual employed by the insurer or other appropriate representative to whom all lawful process shall be mailed. The designee must maintain a legal residence, domicile or office in the United States.

(8) Additional information as may be required by the Commissioner to determine whether the insurer meets the standards and requirements of the Act and this chapter.

(d) After placement on the eligible surplus lines insurer list, an alien insurer shall submit to the Department through a surplus lines licensee:

(1) Changes or additions, or both, to the information in subsections (c) (7) and (4) (i) within 10 calendar days of the occurrence;



(2) Changes or additions, or both, to the information in subsections (c)(1) and (5) within 30 calendar days of the occurrence;

(3) A certified copy of the information in subsection (c)(3)(i) within 30 calendar days after the date required for filing in its domiciliary jurisdiction. A copy of the information in subsections (c)(2), (3)(ii) and (4)(ii) shall accompany the filing.

(4) Additional items as may be required by the Commissioner to determine whether the insurer continues to meet the standards under the Act.



**COMMONWEALTH OF PENNSYLVANIA  
INSURANCE DEPARTMENT**

**OFFICE OF SPECIAL PROJECTS**  
1326 Strawberry Square  
Harrisburg, PA 17120

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Fax: (717) 705-3873  
E-Mail: psalvato@ins.state.pa.us

September 23, 1998

Mr. Robert Nyce  
Executive Director  
Independent Regulatory Review Comm.  
333 Market Street  
Harrisburg, PA 17120

Re: Insurance Department Proposed  
Regulation No. 11-170, Surplus Lines

Dear Mr. Nyce:

Pursuant to Section 5(a) of the Regulatory Review Act, enclosed for your information and review is proposed regulation 31 Pa. Code, New Chapter 124, Surplus Lines.

Pennsylvania's surplus lines laws and regulations were adopted to establish a system of regulation that permits orderly access to surplus lines insurance in this Commonwealth with reputable and financially sound insurers and provides for adequate protections in the insurance marketplace. Pennsylvania's initial Surplus Lines Insurance Law (Act of January 24, 1966, 1965 P.L. 1509, No. 531) was replaced by Article XVI of the act in 1992. The purpose of this rulemaking is to replace the regulations (31 Pa. Code, Chapters 35 and 123) adopted under the authority of the initial Surplus Lines Insurance Law with an updated regulation consistent with Article XVI of the act.

If you have any questions regarding this matter, please contact me at (717) 787-4429.

Sincerely yours,

*Peter J. Salvatore*  
Peter J. Salvatore  
Regulatory Coordinator

TRANSMITTAL SHEET FOR REGULATIONS SUBJECT TO THE  
REGULATORY REVIEW ACT

I.D. NUMBER: 11-170  
SUBJECT: Surplus Lines Insurance  
AGENCY: Department of Insurance

RECEIVED  
98 SEP 23 PM 1:13  
INDEPENDENT REGULATORY  
REVIEW COMMISSION

TYPE OF REGULATION

- X Proposed Regulation  
Final Regulation  
Final Regulation with Notice of Proposed Rulemaking Omitted  
120-day Emergency Certification of the Attorney General  
120-day Emergency Certification of the Governor  
Delivery of Tolled Regulation  
a. \_\_\_\_\_ With Revisions  
b. \_\_\_\_\_ Without Revisions

FILING OF REGULATION

DATE	SIGNATURE	DESIGNATION
9/23/98	<u>Sheila E. Egan</u>	HOUSE COMMITTEE ON INSURANCE
9/23/98	<u>Denise Patton</u>	SENATE COMMITTEE ON BANKING & INSURANCE
9/23/98	<u>Kim C. Warner</u>	INDEPENDENT REGULATORY REVIEW COMMISSION
		ATTORNEY GENERAL
9/23/98	<u>Cynthia Shea</u>	LEGISLATIVE REFERENCE BUREAU

September 22, 1998