

**DRAFT - 8/13/99**

Original: 1988  
Bush  
cc: Wilmarth  
Sandusky  
Legal

**PREAMBLE**

The Insurance Department (Department), by this Order, deletes Chapters 35 and 123 (relating to surplus lines agents) and adopts Chapter 124 (relating to surplus lines insurance) to read as set forth in Annex A. These regulations set 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 nonstandard 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.

The Commonwealth'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. The Commonwealth'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. This rulemaking replaces the regulations adopted under the authority of the initial Surplus Lines Insurance Law with updated regulations consistent with Article XVI of the act.

*Statutory Authority*

These regulations are adopted under the authority of Article XVI of the Insurance Company Law (act) (40 P.S. §§ 991.1601 - 991.1625).

*Comments*

Notice of the proposed rulemaking was published at 28 Pa.B. 40 (October 3, 1998) with a 30-day public comment period.

No comments were received from the standing committees. Comments were received during the 30-day public comment period from the Alliance of American Insurers (Alliance); The Insurance Federation of Pennsylvania, Inc., (IFP) and from Senator Frank A. Salvatore on behalf of Martin G. Lane, Chairman of the Board of Aegis Security Insurance Company (Aegis). On November 12, 1998, comments were also received from the Professional Insurance Agents Association (PIA). The Independent Regulatory Review Commission (IRRC) submitted its comments and recommendations

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to the Department on December 3, 1998. The following is a summary of the comments and the Department's response in its final rulemaking.

The Alliance and the IFP commented in support of the regulations as published in proposed form.

Aegis suggested that the regulation require notice to insureds that a non-admitted insurer is not licensed by the Department, is subject to limited regulation, and that losses would not be covered by the state guaranty fund in the event the insurer becomes insolvent. Section 1608 of the act (40 P.S. § 991.1608) requires surplus lines licensees to provide insureds with 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 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) requires the notice to be substantially similar in content to the language cited in section 1608 of the act and prominently printed on the first page of the quotation. In addition, section 1612 of the act (40 P.S. § 991.1612) requires substantially the same notice to appear on every evidence of insurance negotiated, placed or procured under Article XVI of the act. Therefore, the Department believes that the notice suggested by Mr. Lane is sufficiently addressed in the authorizing statute and section 124.2 of this final-form rulemaking.

The PIA and IRRC commented on provisions in Section 124.5(1)(i) (relating to diligent search of admitted insurers) of the proposed rulemaking concerning the producing broker's duty to make a diligent effort to procure the desired coverage from admitted insurers before having the coverage placed with an eligible surplus lines insurer. 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) of the act, 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. The declaration form prescribed under section 1609(a)(1) of the act (40 P.S. § 991.1609(a)(1)) currently requires the producing broker (or the surplus lines licensee when acting as both the producing broker and the surplus lines licensee) to identify at least three admitted insurers which have declined to insure the risk. Under section 1609(a)(2) of the act (40 P.S. § 991.1609(a)(2)) the surplus lines licensee is also required to file a written declaration of the licensee's lack of knowledge of how the coverage could have been procured from admitted insurers when coverage is placed under the diligent search criterion of the act.

Section 124.5(1)(i) of the proposed rulemaking would have permitted a producing broker with less than three agent appointments to obtain declinations from less than three admitted insurers when placing coverage in the surplus lines market under the diligent

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search criterion. An agent appointment is a written agreement between an agent and an insurer under which the agent may solicit, negotiate, make or procure insurance coverages written by the insurer. See 31 Pa. Code, § 37.1 (relating to definitions.). IRRC commented that the proposed provisions for less than three declinations appeared to penalize brokers and agents with three or more appointments because they would be required to secure three declinations while brokers and agents with less than three appointments would be allowed to secure fewer declinations. The PLA also questioned the basis of the proposed provisions to tie the number of required declinations to the number of appointments but commented on the difficulties producing brokers or surplus lines licensees may face in obtaining declinations from admitted insurers with which they do not have agent appointments. IRRC recommended that the final-form regulation address what is required if a producing broker is unable to secure the required number of declinations. In response to these comments, the Department has amended Section 124.5(1)(i) in this final-form rulemaking to:

1. Delete the proposed provisions to base the number of required declinations on the number of agent appointments, and
2. Add a statement consistent with existing requirements to provide that a diligent effort to procure the desired coverage from admitted insurers shall have been made if the producing broker declares on the form prescribed under section 1609(a)(1) of the act (40 P.S. § 991.1609(a)(1)) that at least three admitted insurers have declined to insure the risk.

The amendment will retain Pennsylvania's historic requirement that producing brokers obtain at least three declinations when placing coverage under the diligent search criterion of the act. At least 42 other states specifically require a diligent search as a condition for placing coverage in the surplus lines market, and at least 11 of those states require a minimum of three declinations to evidence a diligent search. In addition to being a nationally recognized approach to diligent search requirements, the standard requirement for three declinations applies equally to all producing brokers transacting business in the surplus lines market. The historic requirement for three declinations also provides for stronger consumer protection by establishing a uniform minimum standard for the degree of diligence performed by producing brokers when searching the admitted market for available coverages. Under § 124.6 (relating to export list coverages) a diligent search will not be required when placing coverages that appear on the most recent export list of coverages recognized as generally unavailable from admitted insurers. Additionally, a diligent search is not required when placing coverage for a risk that requires a unique coverage not available from admitted insurers. Further, Section 124.5(1)(iv) will permit a producing broker to assume that an admitted insurer has declined to write a risk if the insurer fails to respond within 5 business days. Surplus lines insurers are subject to limited regulation by the Department, and policyholders are not protected by the Pennsylvania Property and Casualty Insurance Guaranty Association in the event of the insolvency of a surplus lines insurer. Therefore, the criteria in Section 1604(2) of the act and the requirements of these final-form regulations are intended to

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permit orderly access to surplus lines insurance in this Commonwealth while providing for adequate consumer protections.

Section 124.5(1)(ii) of the proposed regulations required a producing broker who obtained less than three declinations in conducting a diligent search of the admitted market to attach to the prescribed declaration form a notarized statement affirming the number of agent appointments held by the broker. The PIA commented that this requirement was unnecessary, cumbersome and expensive and recommended it be deleted in the final-form rulemaking. IRRC noted that the purpose of the statement was to affirm the number of appointments held by a broker who obtained less than three declinations, but asked the Department to explain why the statement needed to be notarized. Since the Department has deleted the companion provision in Section 124.5(1)(i) that based the minimum number of required declinations on the number of agent appointments, Section 124.5(1)(ii) is no longer needed and has also been deleted in this final-form rulemaking.

IRRC suggested that the requirements for declinations in Section 124.5(3) of the proposed regulations be included under the provisions of Section 124.5(1) to improve the clarity of the regulation. In response to IRRC's comment, the Department has included the provisions of Section 124.5(3) and (4) of the proposed regulations under Section 124.5(1) in this final-form rulemaking.

Finally, the Department amended Section 124.10(c)(2) (relating to eligible surplus lines insurer filing requirements) to change the word *insurer* to *insure*. The change was made to correct a typographical error in the proposed rulemaking.

### *Fiscal Impact*

#### *State Government*

Department costs associated with the review of applications and reports filed under Chapter 124 will not increase as a result of this final-form rulemaking. The chapter eliminates current costs imposed on the Department and regulated parties related to the filing and review of binding authority contracts. The chapter will serve to enhance the protection of Commonwealth revenues by imposing minimum bonding requirements consistent with premium tax liability.

#### *General Public*

While the chapter has no immediate fiscal impact on the general public, the general public will benefit to the extent that adoption of the chapter enhances the efficiency and effectiveness of the Commonwealth's regulation of surplus lines insurance under Article XVI of the act.

*From Annex***DRAFT - 8/13/99**

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

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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.

(1) Under section 1609(a)(1)(i) of the act (40 P.S. § 991.1609(a)(1)(i)), the producing broker shall 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.

(i) [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:

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

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[(ii) 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.] **A diligent effort by the producing broker to procure the desired coverage from admitted insurers shall have been made if the producing broker declares on the prescribed form that at least three admitted insurers which are writing, in this Commonwealth, coverage comparable to the coverage being sought have declined to insure the particular risk.**

[(iii)] **ii** 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.

[(iv)] **iii** A written record documenting an oral declination shall include:

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

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

(C) The date of contact.

(D) An explanation of the declination.

[(v)] (iv) If an admitted insurer fails to respond within 5 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 subparagraph (iv)(A)--(C).

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

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



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**(A) 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.**

**(B) 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.**

**(C) The restrictions set forth in subparagraph (vi)(A) and (B) do 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.**

(2) Under section 1609(a)(2) of the act, 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. Under section 1609(a)(3) of the act, 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 section 1609(a)(1) and (2) of the act.

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

**[(4) 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).**

**(i) 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.**

**(ii) 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.**

**(iii) The restrictions set forth in paragraph (1)(i) and (ii) do 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.]**

**DRAFT - 8/13/99****§ 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 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.

**DRAFT - 8/13/99****§ 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:



COMMONWEALTH OF PENNSYLVANIA  
INSURANCE DEPARTMENT  
OFFICE OF REGULATION OF COMPANIES  
BUREAU OF EXAMINATIONS  
BUREAU OF LICENSING  
AND FINANCIAL ANALYSIS

FAX COVER SHEET

From FAX Number: (717) 787-8557

DATE: August 13, 1999

TO: Fiona Wilmarth, IRRC

FAX NUMBER: 783-2664

FROM: Elaine Leitzel Telephone (717) 787-8840

RESPOND TO FAX NUMBER: \_\_\_\_\_  
(Only if different from the number shown above)

NUMBER OF PAGES INCLUDING THIS COVER SHEET: 13

If you experience difficulty receiving this FAX and need to contact the Operator shown below, please call (717) 787-2735.

OPERATOR: Elaine Leitzel

MESSAGE

Re: Final Form Regulation No. 11-170 (#1988) - Surplus Lines Insurance. I'm faxing only the pages relevant to the changes in the final form regulation. As we discussed, I'll be out of the office until Thursday, 8/19. In the interim, you may call or e-mail Cris Bybee at 783-2144 or cbybee@ins.state.pa.us. Thanks for your help.

Mailing address for the Office of Regulation of Companies:  
1345 Strawberry Square  
Harrisburg, PA 17120