

**THE SURPLUS LINE
ASSOCIATION OF CALIFORNIA**



*The Story of
Non-admitted Insurance
in California*



THE STORY OF NON-ADMITTED INSURANCE IN CALIFORNIA

It is vital an innovative and imaginative insurance marketplace exist for those insureds requiring extremely large limits of protection or coverages that have exposures of such an unusual nature admitted companies are unable to respond to their insurance needs.

The origins of the Excess & Surplus line market go back to the 1800's when a network developed whereby a broker, unable to find enough American insurers to provide full coverage for their client, could export the business to British insurers thereby covering the necessary limits or unique coverages required. Unlike the admitted market, insurers in the non-admitted market were not subject to the authority of the insurance regulators. They constituted a small percentage

of the total insurance business done in the state and were usually located in a foreign country. As the non-admitted market grew in size, it became obvious to state regulatory authorities they had inadequate controls over this market and additional regulations were needed.

Unlike the admitted market, the insurers in the non-admitted market were not subject to the authority of the insurance regulators.

These new regulations controlled the non-admitted marketplace by regulating the activities of the licensed surplus line brokers.



HISTORY OF THE SURPLUS LINE LAWS

In California, the regulatory law prior to 1937 provided an inadequate form of control over activities of Surplus Line Brokers by the California Department of Insurance (“CDI”). The Insurance Commissioner lacked authority and facilities for effectively policing the activities of licensed insurance brokers who handled non-admitted insurance placements. Therefore, the Commissioner could not properly safeguard the interest of California insurers or admitted insurers nor assess and collect the full taxes provided by law on such activities.

As a result, in 1937, the California Insurance Commissioner recommended the following:

1. A special committee be created to cooperate with the CDI in the drafting of new laws which would provide the Commissioner a means of proper regulation and would permit non-admitted insurers to provide coverages which the admitted market did not readily provide, and;



2. Surplus Line Brokers should form an association, whose purpose is to inform members as to proper procedures and to cooperate with the CDI in providing effective regulation.

This joint effort resulted in the drafting of the California Surplus Line Law, now contained in Chapter 6, Sections 1760 through 1780 of the Insurance Code of California and passed by the

California Legislature in 1937. At the same time, The Surplus Line Association of California (or the “Association”) was formed.

STAMPING OFFICE

In 1938, the California Insurance Commissioner requested the Association create a Stamping Office to administer the functions of the newly created Surplus Line Association of California. Today the most important of these functions are the receipt, review and processing of required policy filings. The Association also performs financial security summary review and analysis to determine whether foreign and alien (beginning in 1994) non-admitted insurers meet the criteria set forth by the CDI.

Association functions as a clearinghouse through which admitted insurers or producers may call attention to transactions believed to be in violation of the law.

The operating expenditures of the Association are defrayed by a mandatory stamping fee which is a percentage of the premium.

The Association also serves as a surplus line advisory organization for the Insurance Commissioner, with various statutory powers and duties. The Association acts as an advisory organization in notifying Association members of incomplete or inaccurate information in transactions filed. The Association functions as a clearinghouse through which admitted insurers or producers may call attention to transactions believed to be in violation of the law.

THE RIGHT TO PURCHASE INSURANCE

State regulation of insurance purchases by its citizens from insurers not admitted in the State is an old problem. The California Surplus Line Law is based on the theory that the right of the buyer to make a contract outside of the State cannot be denied by the State. Therefore, any person may negotiate and effect insurance to protect himself, herself, or itself against loss, damage, or liability with any non-admitted carrier (Insurance Code Section 1760). In cases of direct placements the insured must pay the premium tax in accordance with the Revenue and Taxation Code.

The prudent buyer often wants and needs the advice and services of a qualified representative conveniently available to them in their own State to negotiate such insurance. Such representatives are subject to license and regulation by the State and are called Surplus Line Brokers. Under California law, surplus line insurance may be placed with eligible surplus line insurers through a licensed surplus line broker only in those instances where the insurance for a risk is not available from admitted insurers qualified to write and actually writing such insurance.

PRINCIPAL PROVISIONS OF THE SURPLUS LINE LAW

1. Insurance on a risk in California may be placed through a licensed Surplus Line Broker only in those instances where the insurance is not available from admitted insurers qualified to write such insurance.

2. State laws provide the broker with guidelines as to the types of risks eligible for surplus lines placements and the necessary procedures to be followed in accessing the non-admitted insurer.

3. Restrictions are placed on the surplus line licensee as to which non-admitted insurers it can use for the placement.

4. A clear disclosure to the buyer must be made, stating the risk is being placed with a non-admitted insurer and that guaranty fund protection is unavailable to the buyer.

5. The surplus lines transaction and supporting documentation must be reported to the surplus line advisory organization to verify the placement was handled correctly by the broker.

6. Surplus line transactions are subject to a premium tax levied by the state, charged to the insured and paid or remitted to state authorities by the surplus line broker.

7. No such insurance may be placed with a non-admitted insurer

for the purpose of obtaining a lower premium than the lowest premium at which such insurance is available from an admitted insurer.

8. Surplus line brokers must provide a surety bond guaranteeing they fully comply with the Surplus Line Laws.

The prudent buyer often wants and needs the advice and services of a qualified representative conveniently available to them in their own State to negotiate such insurance.

LESLI

The CDI established a List of Eligible Surplus Line Insurers, known as the “LESLI,” which was first issued on July 7, 1995. The CDI determines whether a particular insurance company meets the State’s standards for eligibility, and if so, the company’s name is placed on the list. Licensed surplus line brokers are prohibited from using non-admitted insurers not on the LESLI (with narrow exceptions).



Effective January 1, 1997, the CDI implemented Senate Bill 1906, requiring individual Lloyd’s Syndicates be identified rather than just showing “Underwriters at Lloyd’s.” Therefore, beginning January 1, 1997, a Surplus Line Broker may only place business with Lloyd’s Syndicates on the LESLI.

ONGOING FILING REQUIREMENTS FOR ELIGIBLE SURPLUS LINE INSURERS IN CALIFORNIA

All filings on behalf of eligible surplus line insurers in California (or those insurers seeking to become eligible) must be made through a licensed California surplus line broker (“contact broker”). Refer to California Insurance Code (“CIC”) Section 1765.1 and California Code of Regulations (“CCR”), Title 10, Section 2174 for the regulatory filing requirements for surplus line insurers. In addition, the CDI has provided a guide outlining the ongoing regulatory filing requirements for eligible surplus line insurers, as well as for those insurers who are seeking surplus

line eligibility in California. This guide is published by the CDI annually and is available on the Association Web site (www.slacal.org).

EXPORT LIST

In recognition of the fact certain types of insurance coverages, or classes of risks, are almost always placed in the surplus line market, an export list was created. The export list was created for coverages or risks that can be “exported” to non-admitted insurers without fulfilling the diligent search requirements (Form SL 2). It is reviewed and updated at least annually by the CDI to reflect changes in market conditions.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA

As the various State Insurance Codes started to address the non-admitted market in more depth, it soon became apparent to the Insurance Departments in many of these states they were not able to handle the large volume of work generated by these new provisions. A solution to the problem was to enlist the help of the surplus line broker community. The regulators realized these brokers could assist in handling some of the more routine matters of the trade and provide valuable background information on non-admitted insurers. This constituted the genesis of The Surplus Line Association of California.

The Association was the first Association of its kind and soon became a model for other Surplus Line Associations throughout the country.

Effective March 30, 1994, the Association was approved to serve as the surplus line advisory organization to the CDI (CIC Sec. 1780.50 to 1780.68). In addition, all surplus line brokers licensed under the surplus line law are deemed to be members of the advisory organization (CIC Sec. 1780.52(b)). While the Association operates as a private, non-profit organization, many of its activities are at the direction and control of the CDI. The SLA has no separate regulatory powers.

THE SURPLUS LINE ASSOCIATION OF CALIFORNIA MISSION STATEMENT

Our mission is to ensure that a responsive and lawful non-admitted insurance market is maintained in California.

Our measure of success in this respect is that the consumer is protected, the needs of the regulators are well served and unlawful activities are curtailed.

Through a professional and committed organization, utilizing state of the art technology and a challenging work environment, we respond to the needs of the California consumer, our membership, and appropriate public agencies. We provide education, processing, evaluation and dissemination of Surplus Line data and information to help ensure the financial integrity and stability of the non-admitted market.

THE PURPOSES OF THE ASSOCIATION

1. To monitor, facilitate and encourage compliance with the Surplus Line Law by its Members.

2. To promote fair dealing between Members and the public, to protect the rights of admitted insurers and to encourage legal use of the surplus line market by Members.

3. To assist the Commissioner in ensuring that those seeking coverage in the California excess and surplus line market have access to financially sound and reputable non-admitted insurers.

4. To maintain a Stamping Office for the receipt, recording and review of documents Members are required to file.

5. To receive and disseminate to its Members information relative to surplus line insurance and to educate and assist its Members in the understanding and interpretation of California surplus lines laws and regulations.

6. To provide such other services to its Members as are incidental or related to the purposes of the Association.



ASSOCIATION OFFICERS AND COMMITTEES

The officers of the Association consist of an elected Chair, Vice Chair and a Secretary Treasurer, and management has been vested in an elected Executive Committee. The Association endeavors to maintain equitable distribution of Executive Committee membership based on size, location and type of the members' operations.

Additional committees are appointed by the Executive Committee, which regularly receives information on their activities. Of greatest importance are the Stamping Office Committee, Legislative Committee, Education Committee, Audit Committee, Automation Committee and Admitted Market Liaison Committee.

THE SURPLUS LINE ASSOCIATION MANUAL

California statutes and regulations applicable to surplus line brokers, as well as other useful reference materials on surplus line placement and filing procedures, surplus line taxes and other relevant topics, are published by the Association in the form of a manual. Many of the statutes and regulations are subject to interpretation in view of changing conditions in the admitted market. These conditions are continuously reviewed both by the Association personnel and by the Association's committees.

CONTACT WITH THE INSURANCE DEPARTMENT

The Association maintains a close relationship with the CDI to assure a continuous exchange of necessary and vital information, essential to the surplus line business.

Since the Association, and particularly its Officers and Executive Committee, are concerned with the operations of the Association and the proper activities of the Surplus Line Brokers within the Surplus Line Law, close contact between the Officers and Executive Committee and the Insurance Commissioner is also maintained.

RECORD KEEPING

Association records are maintained to keep track of total surplus line insurance premium transactions of all members. These records are often of assistance to the CDI in connection with audits and investigations.

Using a sophisticated computer system, the Association compiles comprehensive statistical data concerning California Surplus Line exports, affording a valuable means of measuring the extent to which non-admitted insurers are participating in certain classes of business.

Refer to our Web site (www.slacal.org) for percentages of each major classification and non-admitted premium totals.

FILING WITH THE STAMPING OFFICE

Filings by the Surplus Line Broker with the Association are handled as follows:

The Surplus Line Broker proposing to use a non-admitted insurer is guided by the rules and regulations set forth in the California Surplus Line Law, contained in Chapter 6, Sections 1760 through 1780 of the California Insurance Code and Title 10, Sections 2131 to 2174 of the California Code of Regulations.

The Surplus Line Broker, having concluded the risk appears to be proper for placement, makes a filing with the Association. This filing must be made within 60 days of placing the insurance with a non-admitted insurer.

Unless the Association or the CDI notifies the member the filing is incomplete, the placement then stands as being in compliance with the law for the term of that placement.

STATE TAX AND STAMPING FEE

A California state tax of 3% is imposed on the premium writings of a Surplus Line Broker. The stamping fee has been changed a number of times in the history of the Association; check our Web site (www.slacal.org) for the current rate.

NON-ADMITTED FOREIGN INSURERS

A non-admitted foreign insurer is a U.S. domiciled insurance company that is licensed in its state of domicile but not licensed in California. To operate in California, the foreign insurer must have and continually maintain a minimum of \$15 million in capital and surplus consisting of assets acceptable under the California Insurance Code. It should be noted letters of credit are not acceptable assets.

ALIEN INSURERS

An alien insurer is a non-U.S. domiciled insurance company licensed in a foreign country, but not licensed in California. To operate in California, the alien insurer must have and continually maintain a minimum of \$15 million in capital and surplus consisting of assets acceptable under the California Insurance Code. It should be noted letters of credit are not acceptable assets. In addition, alien insurers must establish a U.S. trust account consisting of cash and marketable securities of no less than \$5.4 million with a U.S. Federal Reserve System Bank member. Letters of credit may be used to fund the trust account, provided they are issued by a qualified U.S. financial institution.

SUMMARY

The Surplus Line Association of California is a unique partnership between brokers, Excess and Surplus line carriers and the California Department of Insurance that ultimately protects California consumers of surplus lines insurance. The result is an insured can find and place insurance — for large limits of protection or exposures of an unusual nature — with a high degree of confidence.

The Surplus Line Association of California publishes this booklet in the interest of providing a better understanding of the Surplus Line Laws of California. These materials should not be viewed as rendering legal advice.

This brochure is advisory only and is not intended to be all-inclusive or original. It does not supersede the actual language of the California Insurance Laws or Regulations. Association makes no warranty or representation as to the accuracy or current effectiveness of the laws and regulations reprinted in this brochure.

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