

From Producer Licensing to Taxes

The Regulatory Landscape of Surplus Lines Insurance

Background

Many of you are likely familiar with, or have dealt with, a risk requiring surplus lines insurance coverage. However, for those of you that do not frequently operate in that space, surplus lines insurance refers to insurance coverage obtained from a non-admitted (a/k/a surplus lines) carrier (i.e., an insurance carrier that does not hold a certificate of authority to issue policies in the state where the subject risk is located).

Access to these surplus lines carriers provides a market of last resort for risks that: (a) admitted insurance companies are unwilling to write; or (b) a state insurance department has designated as unavailable in the admitted insurance market.

Although surplus lines carriers are not regulated in the same manner as admitted carriers, several states publish a “white list” of surplus lines carriers who have verified their financial stability. Surplus lines brokers benefit from using these “eligible” surplus lines carriers because the state has already confirmed that they are financially solvent in the event of a claim.

Nevertheless, state insurance laws have, unsurprisingly, still shifted regulatory and compliance burdens to surplus lines brokers because of the less stringent oversight on surplus lines carriers. This means that surplus lines brokers are responsible for many obligations typically satisfied by admitted insurance carriers, such as submitting policy documents and remitting tax payments. Failure to comply with these obligations can result in administrative actions and monetary fines.

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This article seeks to clarify these obligations and provide a high-level overview of the licensing, diligent search, policy filing, and surplus lines tax requirements imposed on surplus lines brokers.

Surplus Lines Broker Licensing

More than half of U.S. states require both an individual and the business entity s/he owns or is engaged by to be licensed as a surplus lines broker before placing risks with a surplus lines carrier. The individual and entity applicants must generally maintain active property and casualty (“P&C”) insurance producer licenses before obtaining a surplus lines broker license. To complicate matters further: (a) individuals and business entities must be licensed P&C **brokers** in those states issuing separate licenses for insurance agents (i.e., producers representing insurers) and insurance brokers (i.e., producers representing insureds); and (b) business entities can only obtain/maintain their licenses by identifying an individual surplus lines broker to serve as their designated responsible licensed producer.

If an individual meets the above criteria, s/he may need to pass an examination in his or her resident state, and, in a few states, must file a bond, to become a licensed surplus lines broker. Once licensed, a surplus lines broker may be eager to place business with surplus lines carriers. However, there are certain conditions that must be met before doing so, which includes (in most instances) completing a diligent search.

Diligent Search (a/k/a Diligent Effort)

As mentioned above, surplus lines carriers are considered a market of last resort, which means insurance producers should exhaust options in the admitted market before placing business with a surplus lines carrier. Nearly every state requires a retail producer (i.e., the producer referring the risk to the surplus lines broker) or a surplus lines broker to complete a “diligent search” (a/k/a “diligent effort”) among admitted carriers. In other words, before placing a risk with a surplus lines carrier, a producer must contact a certain number of admitted carriers, which varies by state, to confirm that they will not write the requested coverage.

There are certain exceptions to the diligent search requirement, the most notable of which is a state’s “export list.” The export list includes coverages that a state insurance department has determined are not readily available from admitted carriers and, therefore, can be obtained from surplus lines carriers without completing a diligent search. Generally, the surplus lines broker must either file or maintain in its records a document evidencing that a diligent search was completed, or that the coverage is on the export list.

Policy Filings

Many states also require surplus lines brokers to file policy documents or forms summarizing policy information to the state insurance department or surplus lines association. The purpose of the filing is two-fold, as it allows these regulatory authorities to: (a) confirm the surplus lines broker used appropriate policy forms

and included appropriate disclosure (a/k/a “stamping”) language on the policy documents; and (b) track premium amounts for purposes of calculating stamping fees and surplus lines taxes. The states vary with respect to the timing of the filings. For example, some states have a monthly or quarterly filing requirement, while others only require one annual filing. Understanding the process for and timeline of these filings is imperative as late or missed submissions can result in daily fines and administrative actions.

Stamping Fees

Several of those states requiring policy filings also impose a stamping fee that must be paid by the surplus lines broker at the time a policy filing is made. The stamping fee is typically a de minimis amount and is used to fund the operations of state insurance departments and/or surplus lines associations.

Surplus Lines Taxes

Each of the 50 states and the District Columbia imposes a surplus lines tax, which is calculated as a small percentage of the “premium” of the surplus lines policies issued in the state. The tax filings and payments are typically submitted electronically to the state insurance department or surplus lines association by the surplus lines broker. However, as with policy filings, the surplus lines tax due dates vary, with some states using a monthly or quarterly deadline and others requiring one annual submission/payment.

Although the surplus lines tax requirements may seem straightforward, issues can arise based on the lack of uniformity among the states. Below are just a few examples of questions we frequently receive and provide guidance on, which are also interrelated with policy filings and stamping fees.

- Should the individual surplus lines broker or licensed business entity submit policy filings and make associated stamping fee and surplus lines tax payments?
- Is a policy or surplus lines tax filing required when the surplus lines broker did not place any business during the relevant time period (i.e., is a “zero” filing required)?
- Should the surplus lines broker include fees (e.g., policy fees, installment fees, service fees, etc.) as part of the “premium” used to calculate stamping fees and surplus lines taxes?
- How should surplus lines taxes be allocated if a policy covers a risk in multiple states?

Conclusion

The licensing requirements and regulatory obligations imposed on surplus lines brokers can be burdensome and, frankly, confusing. This can overwhelm surplus lines brokers, including prospective licensees, and make compliance with state insurance laws difficult. ACCEL Law Group P.C. (“ACCEL”) has extensive experience advising clients on these and other matters related to surplus lines insurance and we encourage you to contact our team when facing these or related issues.

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ABOUT ACCEL Compliance

ACCEL Compliance provides comprehensive compliance services and software to insurance agents and brokers. We focus on ensuring insurance intermediaries meet their regulatory obligations while freeing their resources to focus on growth. Learn more at [ACCELCompliance.com](https://www.ACCELCompliance.com).

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