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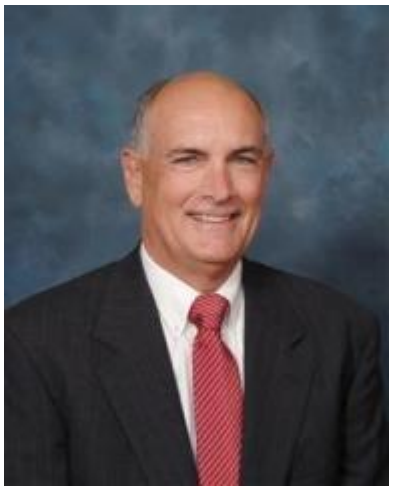

Dick Tutwiler

"It's apparent that the Florida Legislature feels the surplus lines insurance scheme is necessary and valuable to our economy, but also carries the unintended consequences that one policyholder will be treated differently than their neighbor."

Excess & Surplus Lines Insurance...Know the Difference

The following is an excerpt from a presentation by Dick Tutwiler at the 2010 First Party Claims Conference in Providence, RI.

The origin of the surplus lines market goes back to the 1800's when brokers around the world, unable to cover businesses went to British insurers for their unique coverage requirements. Surplus lines insurance provides coverage for risks that do not meet established goals set by admitted carriers or are deemed uninsurable. The risks may be too big, too unusual or of a substandard nature that standard carriers refuse to accept the exposure. As a result, surplus lines policies are priced much higher than "admitted" carriers to reflect this risk.

As a result, surplus lines insurers are not regulated by state insurance regulators the same way licensed or admitted users are. In many cases they are not licensed, giving them the freedom to maintain broader underwriting goals and the flexibility to design policies that cover the risks associated with specific customer needs. Brokers who sell these policies are required to be licensed however and in many states are required to make sure the insurer meets certain financial standards. In Florida, despite the higher pricing, these policies are not protected by the Florida Insurance Guarantee Association (FIGA) fund safety net which pays for losses if an "admitted" carrier becomes insolvent.

Florida ranks #4 behind California, Texas and New York as the biggest market for surplus lines insurance. The *Insurance Journal* recently reported that in 2008, surplus lines carriers collected $4 billion dollars in premiums with tax collected and paid into Florida coffers

to the tune of $200 million. It has been reported that some 700,000 excess and surplus line policies are issued each year in Florida with 40% of them covering personal lines contracts for homes, condominiums and other dwellings.

So what happens when claim disputes arise and the surplus lines adjuster announces they are not regulated by the state insurance department? Two recent bombshell court cases help demonstrate the interplay between the various players in this insurance product.

Essex Insurance Co. v Zota was an opinion issued by the Florida Supreme Court that made a distinction between Chapter 626 and 627 of the Florida Insurance Code as their provisions applied to surplus lines insurance and "admitted" insurance companies. The question was whether delivery of a surplus lines policy to the retail agent constituted delivery to the insured. When the Florida Supreme Court issued their decision it found that surplus lines insurance was not exempt from provisions of the admitted carrier statutory law. This case created great uncertainty on how issues involving policies and forms would be resolved.

A second case in Federal 11th Circuit Court **CNL Resorts & Hotel Inc. v. Twin City Fire Insurance Co.** involved the question of whether a claim for legal fees was enforceable because the policy endorsement that prevented the recovery had not been approved by the State.

The court relied on the Essex case, ruling that the surplus lines form issued was not approved and thus the exclusion for legal fees did not apply. Left standing, these two judicial decisions could have required surplus lines carriers to seek State approval for all their policies, drastically altering their business model. It could also result in negative legal rulings for policy disputes, where policies already in place do not reflect the added risk in their premiums.

As a result of these rulings, surplus lines carriers indicated they may not continue operating in the Florida market unless the issue was clarified by the legislature. In June 2009, a bill was signed that restored the surplus line regulatory exemption of forms and policies from State regulation.

Has the new law brought clarity and fairness to the policyholder and especially in personal lines? Not likely, particularly regarding payment of claims and the fairness issue.

Surplus lines homeowners will be treated differently after a loss than their neighbor who may have an "admitted" insurance carrier. The current law for "admitted" carriers is that they have to pay the replacement cost of a loss on both contents and dwelling. Surplus lines carriers who claim they are exempt from the admitted carriersrules and regulation are paying the actual cash value of a loss until work is completed on the building and replacement of the contents is made if there is contents replacement cost coverage.

While it is apparent that the Florida Legislature feels the surplus lines insurance scheme is necessary and valuable to our economy, it also carries the unintended consequences that one policyholder will be treated differently than their neighbor. When the next Big One hits Florida, you can bet this will be a well-discussed issue with homeowners, their agents and the Florida Legislature.

Send comments to:

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