EXCESS LINES AND ALTERNATIVES: A PRIMER

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More Risk, More Control

There are several options for insurers and insureds who do not want to take a conventional approach.

Instead of using insurance policy forms approved by state regulators, there are options for those looking for or needing something different.

States Regulate Insurance

- *McCarren-Ferguson* - individual states are responsible to license, regulate and oversee insurers
- **Exception** – surplus lines (a/k/a “excess lines”) insurers who provide insurance in a state without being licensed by that state.

Insurer’s Domicile

- The state where an insurer is formed or organized has primary regulatory oversight for that insurer -- In New York, the New York State Department of Financial Services has that responsibility.
- An insurer organized under New York law is a “domestic” insurer. When doing business in other states, it acts as a “foreign” insurer.

Licensure

- Insurers must generally be licensed in a state to sell insurance there.
- Once licensed, an insurer is referred to as "admitted", "authorized" or "standard lines"
- Either domestic or foreign insurers may be admitted or authorized in a given state.
- "Alien" insurers are insurers organized or formed in foreign countries.
- NAIC creates, "Quarterly listing of Alien Insurers" re: eligibility of non-admitted alien insurers ("NAIC IID List").

Approval of Rates and Forms

- Authorized domestic or foreign insurers must seek approval of rates and forms, as a prerequisite to issue policies or underwrite risks.
- Rates and forms must comply with applicable statutes/regulations.
- In New York, See NY Insurance Law, Articles 23, 31 and 34 for form and content rules.

The Excess Lines Exception

- Non-admitted, unauthorized, surplus lines or "excess lines" insurers may write certain lines of business in states if "eligible."
- Most types of property, casualty and surety coverages can be written as excess/surplus lines.

Exception, con't

In New York, excess lines insurers cannot write primary auto liability coverage, life insurance, accident and health, workers' compensation, title insurance or primary medical malpractice coverage.

Eligibility Requirements

- Must re-qualify each year.
- Submit financial data, including annual statement, audited financial statements of parent company, most recent financial examination by domiciliary regulator.
- Application to Excess Lines Association of NY (“ELANY”) showing policyholders’ surplus of at least $46 million.

How Do You Know A Particular Insurer is eligible excess lines Insurer?

- Check ELANY website (www.elany.org)
- Also, if you see New York required excess lines notice, as follows:

NEW YORK NOTICE

“THE INSURER(S) NAMED HEREIN IS (ARE) NOT LICENSED BY THE STATE OF NEW YORK, NOT SUBJECT TO ITS SUPERVISION, AND IN THE EVENT OF THE INSOLVENCY OF THE INSURER(S), NOT PROTECTED BY THE NEW YORK STATE SECURITY FUNDS, THE POLICY MAY NOT BE SUBJECT TO ALL OF THE REGULATIONS OF THE INSURANCE DEPARTMENT PERTAINING TO POLICY FORMS.”

Advantages to Excess Lines

- Not required to submit rates and forms to state for approval – policy may contain terms not permitted by state for authorized insurers.
- Nimble – can react quickly to changes in the marketplace without waiting for regulator approval.
- Fill in gaps in marketplace when particular policy unavailable from authorized insurer.

Coverage Differences

- For commercial lines, statutory cancellation and non-renewal notice requirements are not applicable . (Insurance Law, §3426) (But not for personal lines. See Insurance, §3425).
- Regulation (11 NYCRR Part 73), limiting types of policies that can use claims-made coverage and imposing minimum standards, does not apply
- Regulation (11 NYCRR Part 71), prohibiting most policies where defense costs reduce policy limits, does not apply.

Risk to Insureds

- Guaranty Funds don’t cover excess lines insurers.
- Risk of insurer insolvency borne by insured.
- Excess lines insurers do not contribute to guaranty funds
  - Property/Casualty Security Fund
  - Public Motor Vehicle Liability Security Fund
  - Workers’ Compensation Security Fund
  - Generally these funds provide up to $1 million protection when New York authorized insurer becomes insolvent

Excess Lines Brokers

- Must be licensed by NY Dept. of Financial Services
- Before placing risk with excess lines insurer, must have received rejections from three authorized insurers which write (or might consider writing) the kind of insurance requested.
- However, failure to attempt to place with three authorized insurers does not invalidate the issued excess lines policy.

3 Declinations not Required for the "Export List"

- Liability for asbestos, fungi and water damage remediation
- Liability for owners of amusement rides
- Builders risk > $10mm
- Commercial excess/umbrella liability (over underlying limits or SIR of $10mm or more)
- Pollution liability
- Liability for GCs and Subs in construction

Due Diligence by Broker

- Prior to placing NY insureds' risk with excess lines insurers, broker must review:
  - Foreign insurer's most recent annual statement
  - Evidence that alien insurer (not a US company) is listed on NAIC IID list
  - Most recent examination report by domiciliary state
  - Certificate of authority for that line of business

Agent for Service of Process

- Excess lines insurers deemed to designate the NYS Dept. of Financial Services as agent for process if they issue policies to NYS residents or corporations authorized to do business in NYS or otherwise collect premiums or transact business in NYS. See Insurance Law, §1213(b).

Other Options

What other options are there besides authorized or excess lines insurers?

- Captives
- Risk Retention Groups
- Mutual Companies
- Self-Insured Workers Compensation Trusts

Captives

- Over 40% of major US companies have one or more insurance captives. Increasingly used for small and mid-sized companies
- May not provide insurance to public generally
- Two kinds: (a) pure captive and (b) group captive

Pure Captive

- Captive is 100 percent owned by or is statutory subsidiary of an “industrial insured”
- Industrial insured is
  - net worth > $100mm;
  - member of holding co. whose net worth > $100 mm;
  - The MTA and its subsidiaries
  - A city with population of at least one million

Group Captive

- Domestic insurer formed for primary purpose of insuring or reinsuring risks of industrial insured group
- Industrial insured group is any group of unaffiliated industrial insureds engaged in similar or related business activities.

Why Captive Insurance?

- Flexibility in policy design and claims handling
- Coverages may differ from approved forms
- Customizable
- However, captives are not permitted to write certain lines of business.

Risk Retention Groups

- Self-insurance through insurance cooperative
- Similar to captive, but retention group includes unaffiliated policyholders which own equity in the group.
- “Shell” insurance company formed by group
- Shell company pays out on small claims, reinsures large losses
- TPAs handle claims; MGAs underwrite.
- Created by federal statutes - - - The provisions of Insurance Law, §3420, are preempted.

Mutual Companies

- Under NY law, must have at least 7 directors
- Officers are elected by the board
- Each policyholder is a “member” with voting rights and receives “dividends” declared by the board.
- Policyholders have right to inspect the books.
- Can generally write same kinds of insurance that stock companies write.

Self-Insured Workers Comp. Trusts

- All members/participants are in same industry
- Periodic contributions in amounts based on each member's anticipated liabilities
- Members jointly agree to be responsible for compensation for employees of each member.
- Recent problems due to insufficient funding of certain WC trusts.

Questions?