

INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF INSURANCE

Surplus Lines Insurance: Policy Form Approval Procedures, Standards and Placements of Coverage with Surplus Lines Insurers and Ineligible Unauthorized Insurers

Adopted New Rules: N.J.A.C. 11:1-33

Proposed: February 4, 2002 at 34 N.J.R. 641(a)

Adopted: December 20, 2002 by Holly C. Bakke, Commissioner, Department of Banking and Insurance

Filed: December 20, 2002 as R. 2002 d.37, **with substantive and technical changes** not requiring additional public comment (see N.J.A.C. 1:30-6.3).

Authority: N.J.S.A. 17:1-8.1, 17:22-6.43, 17:22-6.45 and 17:22-6.41

Effective Date: February 3, 2003

Expiration Date: January 31, 2006.

Summary of Public Comments and Agency Responses:

The Department received nine written comments on the proposed new rules during the comment period. Comments were received from three insurers (Centennial Casualty Company, General Star Indemnity Company and Lloyd's of London) and five trade associations (Independent Insurance Agents of New Jersey, Insurance Brokers Association of New Jersey, National Association of Professional Surplus Lines Offices, Professional Insurance Agents of New Jersey and the Surplus Lines Association of New Jersey) and Skyline Auto Exchange.

COMMENT: One commenter stated that the definition of “diligent effort” found in N.J.A.C. 11:1-33.2 could be improved by removing the word “means” and replacing it with the phrase “a process by which.” The commenter stated that this would clarify that the “diligent search” is an activity performed by a “New Jersey insurance producer.”

REPOSENSE: The Department agrees with the commenter and has amended these definitions to read , “‘Diligent effort’ means a process by which a licensed New Jersey insurance producer places coverage...”.

COMMENT: One commenter stated that N.J.A.C. 11:1-33.3(a) provides that a surplus lines agent may export coverage without making a filing so long as the policy form “contains substantially the same terms and conditions” that are in policy forms that have been filed by an authorized insurer. However, in proposed N.J.A.C. 11:1-33.4(a), surplus lines agents are required to file policy forms that “modify the coverage provided for in forms approved in the admitted market.” The commenter contends that this language appears to broaden the category of those policy forms that require filing from those established in N.J.A.C. 11:1-33.3(b) because it calls for a filing when coverage provided for in forms approved for admitted insurers is “modified” in any way. As a result, under this proposed new standard, surplus lines agents could be required to file a great number of forms with the Department.

Therefore, the commenter suggested that proposed N.J.A.C. 11:1-33.4(a) be amended to track as closely as possible the language in N.J.A.C. 11:1-33.3(b):

“Surplus lines agents may file with the Commissioner on behalf of surplus lines insurers policy forms or contracts that do not contain substantially the same terms and conditions that are in policy forms and contracts that are currently filed by and in use by an authorized insurer for the same line or lines of insurance.”

RESPONSE: The Department disagrees with the commenter. N.J.A.C. 11:1-33.3(b) addresses situations when a surplus lines agent is able to export coverage to a surplus lines insurer, without making a filing. N.J.A.C. 11:1-33.4(a) addresses the criteria that must be met when a surplus lines insurer files policy forms that modify coverage for forms in the admitted market.

COMMENT: One commenter stated that N.J.A.C. 11:1-33.4(a) provides the standards that must be met for the approval of policy forms that do not meet the exemption from filing requirements in N.J.A.C. 11:1-33.3(b). The commenter stated that the rule text of N.J.A.C. 11:1-33.4(a) does not track that of N.J.A.C. 11:1-33.3(b) with respect to the description of the policy forms that are exempt from filing. The commenter believes N.J.A.C. 11:1-33.4(a) should be modified to reflect that same standard noted in N.J.A.C. 11:1-33.3(b).

RESPONSE: The Department disagrees with the commenter. N.J.A.C. 11:1-33.3(b) addresses exemptions, and N.J.A.C. 11:1-33.4 addresses the forms that have to be filed. Therefore, there is no need for the language to be the same. These provisions address different requirements.

COMMENT: One commenter stated that in N.J.A.C. 11:1-33.4(a)2, there appears to be numbering or formatting error. The commenter stated that subsection (a) appears to actually be a new subsection (b). Similarly, a third subsection (a) appears to be new subsection (c), and subsection (b) appears to be new subsection (d).

RESPONSE: The Department disagrees. The rule that appears in the Monday, February 4, 2002, New Jersey Register contains the correct format and codification.

COMMENT: One commenter stated that, with respect to N.J.A.C. 11:1-33.4(c), it commends the Department and agrees with the intent behind the its proposal to increase the number of forms that may be filed within any 30-day period from five to 10. However, the commenter believes that the revisions may not go far enough in improving the ability of surplus lines insurers to respond to consumers' demands in the market.

The commenter stated that in the surplus lines market, and particularly with respect to those risks that are difficult to place, the policy documentation for a specific risk may be comprised of many forms. In the event that a complex risk generates numerous endorsements, this proposal would unnecessarily hamper the ability of a surplus lines agent to file the forms with the Department in accordance with the applicable regulatory requirements.

The commenter believes that while the inclusion of a provision for a waiver is a possible solution, there are timing issues that will result from a waiver and will render this approach impractical. The commenter stated that a surplus lines agent would have to request a waiver, await the determination of its waiver request, yet still be required to file the forms not less than 30 days before the effective date of the policy. The commenter stated the combination of these two deadlines imposes an onerous requirement on the surplus lines agent and renders it effectively impossible for him to request a waiver and still submit the forms 30 days prior to the policy's effective date.

The commenter suggested that the alternative is to simply increase the number of forms that may be filed within any 30-day period to 20. The commenter recommended that the 30-day period in which a surplus lines agent may submit filings comprised of more than 10 forms be decreased to 15 days so that there would be greater latitude for large filings to be made.

RESPONSE: This rule allows organizations or agents to request a waiver if it is for a new line of coverage. Given the Department's ability to review these forms, the Department believes that the 10-form filing limit requirement is reasonable.

COMMENT: One commenter commended the Department with respect to N.J.A.C. 11:1-33.4(e) for incorporating a "30-day deemer" provision in this Subsection. The commenter believes this will reduce uncertainty in the minds of surplus lines agents and surplus lines insurers as to whether an approval will be provided by the Department.

RESPONSE: The Department agrees with the commenter. The Department believes this requirement will provide agents and insurers with a time frame by which they can expect a form to be approved or disapproved by the Department.

COMMENT: One commenter stated that N.J.A.C. 11:1-33.5(a) is quite restrictive and is inconsistent with the premise that the surplus lines market operates as the market of last resort for difficult-to-place risks. The commenter stated that mandating coverage of these exposures subverts the purpose of the surplus lines market. To require the insurance of these exposures does not create and foster a limited insurance market in which consumers with extremely hazardous exposures may obtain coverage. The

commenter contends that by compelling surplus lines insurers to cover the three types of exposures listed in subsection (a) is, in many instances, tantamount to compelling them to decline such risks.

The commenter stated that it believes that the Department should not list the exposures that may not be excluded by insurers. Rather, the commenter believes that the Department should, over time, evaluate the insurability of these types of exposures on a case-by-case basis as surplus lines agents file the forms for individual risks. The commenter stated that since the surplus lines marketplace reacts to changes in the traditional admitted market, it would be unwise to mandate coverage of these exposures in a regulation, thereby requiring amendment of the regulation to permit surplus lines insurers to exclude them in the future.

Additionally, the commenter stated that in paragraph (a)2, the phrase "communicable disease" is undefined and therefore subject to broad interpretation, conceivable encompassing disease ranging from HIV to influenza. The commenter recommended that the Department further define and clarify this term.

RESPONSE: The Department disagrees with the commenter. The Department believes that the rules as proposed represent an appropriate balance between the function of the Surplus Lines market as described by the commenter and reasonable coverage as expected by insureds. N.J.A.C. 11:1-33.4(a) sets forth appropriate requirements that are intended to address the commenter's concern that certain insurers may require special exclusions in order to provide coverage to specific kinds of insureds. Additionally, the provisions of N.J.A.C. 11:13-7.4 provide responsible limitation on surplus lines coverage for habitational risks. The Department notes that

these rules codify current Department requirements with respect to which exclusions should or should not be allowed, and that it is appropriate to include these exclusions in these rules, since they are currently accepted in the market. The Department has clarified that these exclusions do not apply to policies that meet the requirement of N.J.A.C. 11:1-33.4(a) (that is, that render a form unique and designed for use with respect to a particular subject of insurance that is a single insured.)

The Department recognizes that “communicable disease” may encompass various diseases but as stated above N.J.A.C. 11:1-33.4(a) provides for appropriate exceptions.

COMMENT: One commenter expressed concern with N.J.A.C. 11:1-33.5(b)I and stated that the use of the phrase “habitational” in this provision was ambiguous and subject to interpretation. The commenter stated that while it appears that the Department's intent is to prohibit the use of claims-made language in all policies that provide any “habitational” coverage, the commenter is concerned that the intent may be only to ban such language from homeowners insurance policies. However, as written, this provision will prohibit claims-made language from being inserted in policies that cover apartment dwellers, owners of condominiums, owners of cooperatives and owners of mobile homes. The commenter stated that the Department's intent is only to ban such language from homeowners insurance policies, this language is overly broad and should be revised.

RESPONSE: The Department notes that sexual abuse exclusions should be permitted in the same manner that they are permitted in the admitted market (as long as the admitted market offers an optional buy back coverage).

In regards to claims made language on habitational risks, claims made forms should not be used on homeowner's policies or liability coverage for one to four family dwellings.

COMMENT: One commenter stated that N.J.A.C. 11:1-33.5(b)2 is also quite restrictive and is inconsistent with the premise that surplus lines market operates as the market of last resort for difficult-to-place risks. In addition, the commenter also believes that N.J.A.C. 11:1-33.5(a) unreasonably omits many major lines of coverage from the proposed exception to the prohibition against including defense costs within the limits of liability. For example, directors and officers liability and many classes of professional liability insurance, including that for accountants, architects and engineers, etc., are not included. The commenter questioned whether this is an intentional omission and, if so, whether this exclusion is justified by market-based consideration.

Finally, the commenter stated that the term "physician liability coverages" does not encompass dentists, podiatrists, osteopaths, veterinarians, chiropractors and, perhaps most importantly, hospitals. The commenter questioned whether this is an intentional omission and, if so, whether this exclusion is justified by market-based consideration.

RESPONSE: The Department disagrees with the commenter's first comment. The Department believes that N.J.A.C. 11:1-33.5 as proposed represents an appropriate

balance between the function of the surplus lines market and reasonable coverage as expected by insureds.

The prohibition on Defense Costs within Policy Limits would only apply to forms required to be filed by N.J.A.C. 11:1-33.3(a). The examples provided by the commenter pertain to “special risks” which do not have to be filed as they are exempted per N.J.A.C. 11:1-33.3(c). The Department has amended the term “physician liability coverages” to include the term professional (“physician profession liability coverage”).

The commenter is correct that the term “physician liability coverages” does not encompass those professions noted above, since those coverages are likewise “special risks.”

COMMENT: One commenter commended the Department regarding N.J.A.C. 11:1-33.6(a), a provision that provides for the recordkeeping of previously disapproved policy forms. The commenter stated that this mechanism would assist surplus lines insurers and surplus lines agents in their quest to determine whether a particular form has been previously disapproved by the Department.

The commenter suggested that, in the near future, the Department establish a “user-friendly” set of internal rules governing the accessibility of these records. The commenter stated that surplus lines insurers and agents would benefit greatly if these records were easily accessible, without undue advance notice or other administrative requirements. The commenter stated that, if upon visiting the Department’s office, surplus lines insurers and agents could access these records through Department personnel, then this would be very helpful.

RESPONSE: Records can be reviewed by submitting a request to the Department.

COMMENT: One commenter expressed concern with N.J.A.C. 11:1-33.8(b)3I, which addresses the deposit that is to be made with the Commissioner. The commenter stated that this provision may require it to post \$100,000 in U.S. Government bonds in order to continue writing coverage for its auction. The commenter stated that this might make it difficult for it to obtain the special insurance coverage tailored to the auction industry. The commenter stated that the loss prevention service and recovery program have been major contributions to the development of the auto auction industry. The commenter stated that it is the only company that writes this type of insurance.

The commenter suggested that the Department modify its rules to give the Commissioner the discretion to modify or waive the deposit requirement for reputable insurance companies that provide unique products.

RESPONSE: The Department disagrees with the commenter. The Department believes that the deposit requirement is reasonable and applicable to all ineligible unauthorized insurers. An insurer's reputation is not a reasonable basis for waiving the deposit requirement.

COMMENT: One commenter expressed concern with N.J.A.C. 11:1-33.8(b)3 This provision requires the deposit to be separately made for each individual policy. The commenter stated that it specializes in writing check and title insurance for automobile auction facilities in order to protect them against bad checks and losses resulting from stolen cars. The commenter noted that it has covered one automobile auction facility in

New Jersey for years. The commenter stated that the insured has been unable to secure coverage in either the admitted or the surplus lines insurance market in New Jersey. The commenter stated that the annual premium is less than \$50,000. Under the Department's proposal, the commenter contends that it would be required to post a deposit of \$100,000, which could be reduced only upon a defined showing of "good cause." The commenter stated that one of the criteria for the reduction of the deposit is that the insurer have a rating in one of the three highest rating categories from a company listed in N.J.A.C. 11:1-41.3 (such as A.M. Best).

The commenter stated that it currently has an A rating from A.M. Best, but that rating could drop another level and, under the Department's proposal, this will preclude any reduction in the requisite bond of at least \$100,000. In addition, since the annual premium on the risk insured in New Jersey is under \$50,000, a deposit of any significant amount would be problematical. The commenter recommends that N.J.A.C. 11:1-33.8(b)3iii be amended to read as follows (deletions in brackets; additions in boldface):

- iii. Upon good cause shown, the amount of deposit provided in (b)3iii above [shall] may be reduced or waived, in the Commissioner's discretion. A showing of good cause requires:
 - (1) a rating in one of the [three] four highest rating categories from a company listed in N.J.A.C. 11:1-4.3; except that a Weiss Rating must be in its highest category;

The commenter stated that, with these changes, it would be able to continue to provide coverage to its New Jersey insured, and the interests of the New Jersey insurance buying public would be adequately protected.

RESPONSE: The Department believes that the deposit requirement is reasonable. Additionally, the Department notes that the company does have the option of becoming

an eligible surplus lines insurer. The Department has changed N.J.A.C. 11:1-33.8(b)3iii regarding the company's rating in accordance with the commenter's suggestion.

COMMENT One commenter stated that New Jersey is one of only two States that require surplus lines policy forms to be approved. The commenter believes that the requirement runs counter to the surplus lines mechanism's essential characteristic of rate and form freedom which exists in virtually all other states. The commenter stated that the surplus lines market is to fulfill its mission of serving consumers by solving their difficult insurance coverage problems, then the market must operate free of rate and form restrictions and limitations. To require it to function in any other manner is to thwart its purpose and deny consumers its benefits.

The commenter stated that what now exists in the State of New Jersey is a restrictive supplemental or secondary market in which eligible surplus lines carriers lack the flexibility of form to respond adequately to insureds who look to solve their insurance problems in the surplus lines marketplace.

In light of the statutory requirements, the proposed rule, although restrictive, appears to be one that allows brokers and consumers reasonable access to the New Jersey surplus lines market within the limited confines of the statutory form filing requirements.

RESPONSE: The Department appreciates the commenter's concern. The Department's proposed rules set forth and codify the Department procedures for the procurement of insurance from surplus lines insurers and ineligible unauthorized

insurers. The Department believes these rules are necessary and reasonable for the filing of surplus lines policy forms that are to be used in the surplus line market.

Federal Standards Statement

A Federal standards analysis is not required because these new rules set forth standards and other requirements concerning insurance and are not subject to any Federal standards or requirements.

Full text of the adoption follows (additions to proposal indicated in boldface **thus**; deletions from proposal indicated in brackets with asterisks **[thus]**):

11:1-33.2 Definitions

The following words and terms, when used in this subchapter, shall have the following meanings unless the context clearly indicates otherwise:

...

"Diligent effort" means a **process by which a** licensed New Jersey insurance producer **[who]** places coverage on behalf of a New Jersey insured with a surplus lines insurer after the risk has been declined by three authorized insurers, each of which is authorized in New Jersey to write insurance of the kind requested and is an insurer that the producer has a good faith reason to believe might consider writing the type of coverage or class of insurance involved.

11:1-33.7 Refile policy forms

(a) (No change from proposal.)

(b) Policy forms refiled in accordance with this section shall, in addition to the completed Surplus Lines Policy Form Filing Questionnaire, be accompanied by a certification of a surplus lines agent stating that the policy form is being refiled in accordance with the standards set forth in this subchapter. Policy forms must be refiled ~~*[within 90 days of the effective date of this subchapter]*~~ **April 21, 2002** in order to be effective no later than ~~*[120 days from the effective date of this subchapter.]*~~ **May 21, 2003**.

11:1-33.8 Surplus lines insurance coverage procurement requirements

(a) (No change from proposal.)

(b) When coverage on behalf of a New Jersey insured cannot be placed with an authorized insurer pursuant to (a) above, a New Jersey licensed surplus lines agent may place the coverage with an ineligible unauthorized insurer. Procurement of insurance from an ineligible unauthorized insurer may be made only when it is not otherwise procurable from admitted insurers or a surplus lines insurer and only if the expressed conditions in (b)1 through 5 below are fully satisfied at least five working days to the binding of insurance coverage.

1. - 2. (No change from proposal.)

3. The ineligible unauthorized insurer shall have made a deposit or deposits with the Commissioner as follows:

i. - ii. (No change from proposal.)

iii. Upon good cause shown, the amount of deposit provided in (b)3iii above shall be reduced ***or waived, in the Commissioner's discretion***. A showing of good cause requires:

1. A rating in one of the ***[three]* *four*** highest rating categories from a company listed in N.J.A.C. 11:1-41.3; except that a Weiss Rating must be in its highest category;

(2) – (3) (No change from proposal.)

4. – 5 (No change from proposal.)

(c) – (f) (No change from proposal.)

DHT02-20/INOREGS