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**REPORT ON LEGISLATION BY THE
COMMITTEE ON INSURANCE LAW**

A.9783	**M. of A. Morelle**
S.6808	**Sen. Seward**

AN ACT to amend the insurance law, in relation to domestic excess line insurance companies.

The Committee on Insurance Law of the New York City Bar Association is pleased to have this opportunity to comment on A.9783/S.6808 (the "Excess Line Legislation"), which would amend the New York Insurance Law ("NYIL") by adding a new Article 58 authorizing domestic excess line insurance companies. The Excess Line Legislation was approved by the Senate on June 12, 2012 and is pending in the Assembly.

The Committee on Insurance Law is composed of lawyers representing a diverse cross-section of the insurance community, including lawyers in private practice, in-house counsel at insurance carriers and producers across multiple lines of insurance business, trade association officials, regulators, policyholder lawyers, insurance arbitrators and other types of insurance professionals. This letter represents the views of the Committee as a whole; it does not necessarily represent the views of any individual members of the Committee or their respective law firms, clients or employer organizations or, in the case of Committee members employed by governmental agencies, the views of any governmental official, agency or branch.[1]

Introduction and Summary Position

The Committee supports the Excess Line Legislation subject, however, to the qualifications discussed herein. These include our concerns regarding (i) the possible perception that New York has approved a new, less-regulated class of insurer to compete with admitted insurers for certain lines of business, (ii) the role of existing and future excess line brokers under the Excess Line Legislation, and (iii) the efficacy of the Excess Line Legislation in enabling a single carrier to underwrite excess line risks in all 50 states.

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[1] This letter was prepared by a subcommittee of the Committee on Insurance Law comprising Terry Cummings, Robert Fettman, Frederic Garsson, Matthew Gaul, Jill Levy, Richard Liskov, Patricia Lubey, Francine Semaya, Eric Suben and Dan Rabinowitz. Committee members Robert Easton and Joana Lucashuk are Executive Deputy Superintendent and Senior Attorney, respectively, at the New York Department of Financial Services. Accordingly Mr. Easton and Ms. Lucashuk have recused themselves from all Committee deliberations on the position expressed herein.

As a general matter, the laws in the various states, including New York, governing excess line business have been successful in providing broader options for sophisticated purchasers of insurance. These laws recognize that, for more specialized risks, the benefit to the insured from rate and form requirements may be outweighed by the need for flexibility and scalability of coverage. At the same time, with limited exceptions, excess line carriers are subject to the full array of financial regulation as an admitted carrier in at least one state or jurisdiction.

The best reforms to the excess line market will be those that (i) perpetuate the flexibility of the excess line system for sophisticated insureds, (ii) encourage regulatory uniformity across state boundaries, as contemplated by the federal Nonadmitted and Reinsurance Reform Act of 2010 (the "NRRA"),[2] (iii) support a level competitive playing field for participants in the insurance market that is appropriate to their particular sector (admitted or nonadmitted), and (iv) maintain appropriate regulatory oversight.

Avoiding the Perception of a New, Less Regulated Class of Insurer and Ambiguity Concerning Application of NYIL to Domestic Excess Line Carriers

Committee Comment: The new law should specify that, except as set forth in new Article 58 (in which specific NYIL provisions would be identified as inapplicable), domestic Excess Line insurers will be subject to all of the provisions of the NYIL.

Rationale: Generally, U.S.-based excess line insurers are licensed in a single state and write insurance exclusively or predominantly outside their domiciliary jurisdiction. Accordingly, the excess line sector may be regarded as a market of insurers writing business free from rate and form requirements on risks that admitted carriers have declined.

Outside their domiciliary jurisdictions, these insurers compete with one another on an even playing field from the standpoint of regulatory compliance obligations. Within their domiciliary jurisdictions, they are subject to the full array of financial regulation as admitted insurers. Because they do not write business in their state of domicile, consumers in such state are not disadvantaged by the inapplicability of rate and form regulation in that state to such carrier. (To the extent the carrier writes *admitted* lines in its domiciliary state, the carrier must observe rate and form requirements and other regulatory restrictions. Again, this creates a more or less level playing field for competing carriers.)

We note in this regard that in both Illinois's and New Jersey's statutes authorizing domestic excess line insurers, such an entity is essentially a domestic insurer with a lower minimum capital requirement.[3] In New Jersey, such an insurer is not permitted to write private passenger auto, workers' compensation or workers' occupational disease coverages, but appears otherwise

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[2] Tit. V, Subtit. B of the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203 ("Dodd-Frank").

[3] N.J. Stat. § 17:22-6.69b; § 215 ILCS 5/445a.

subject to all of New Jersey's provisions governing domestic insurers.[4] In Illinois, a domestic excess line carrier is exempt from certain guaranty fund, assigned risk and residual coverage requirements and similarly is prohibited from writing certain auto, workers' compensation and workers' occupational disease coverages.[5] The lower capital requirement, it could be argued, puts these carriers at an advantage; however, customary application of maximum premium-to-surplus ratios should limit the premium writings of all carriers to amounts that are commensurate with their capacity. Consequently, the minimum capital requirement by itself is likely neutralized as a competitive issue.

Domestic excess line carriers as contemplated by the New York Excess Line Legislation, by contrast, would appear to represent a departure from the existing regulatory scheme. Unlike the statutes in New Jersey and Illinois, which impose *all* of their domiciliary requirements on domestic excess line carriers, carving out provisions on a surgical basis, the proposed Excess Line Legislation enumerates (i) specific provisions of the NYIL to which domestic excess line carriers are subject[6] and (ii) others from which they are exempt,7 such as participation in New York guaranty funds. Although the former category does include some of the main prudential provisions of the NYIL,[8] we are concerned that the structure of the legislation creates, in effect, a lower ceiling on the ability of New York regulators to oversee these entities or at least the appearance of such.[9]

This effect in turn could distort the market between carriers in the traditional excess line market and carriers in a new, more ambiguous class of insurers domiciled in New York writing the same or similar lines. This kind of artificial competitive advantage or disadvantage is not in the best interest of consumers in New York or elsewhere. Furthermore, this could have an adverse effect on the compliance culture and habits of Excess Line carriers subject to the new Article 58 to the extent these carriers conclude that their regulatory oversight is more relaxed.

In short, by creating a new species of insurer not subject to domiciliary regulation in New York (or elsewhere), the Excess Line Legislation could alter the competitive balance between carriers

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[4] N.J. Stat. § 17:22-6.69b(a), (c). We note incidentally that domestic excess line carriers in New Jersey are also subject to the requirements of New Jersey's surplus line security fund. N.J. Stat. § 17:22-6.72 *et seq.*; § 17:22-6.45(b). New York, of course, does not have such a fund.

[5] § 215 ILCS 5/445a(c).

[6] Proposed NYIL § 5806.

[7] Proposed NYIL § 5807. The interplay between Section 5806 and Section 5807 (for example, exemption from application of the Property/Casualty Insolvency Fund established by Article 76 of the NYIL) potentially creates ambiguity. Specifically, if an NYIL provision is mentioned in *neither* Sections 5806 nor Section 5807, is a domestic excess line carrier subject to it or exempt from it?

[8] *E.g.*, Article 15 concerning holding companies, Article 14 on investments and Article 13 on assets and deposits.

[9] Another unintended consequence might involve out-of-state or alien companies seeking to redomesticate into a U.S. state in order to establish an excess line platform. Based on the Illinois and New Jersey statutes, those states' regulators would presumably require a full redomestication of such a company into the state prior to seeking qualification as a domestic excess line insurer. In New York, under the Excess Line Legislation, this is less clear insofar as a domestic excess line carrier is not a true "domestic". This could give rise to ambiguities and inconsistencies in terms of how (or whether) such non-New York companies are to be redomesticated here.

writing similar lines of business. We would urge the legislature to bear this in mind as it considers the Excess Line Legislation and to take appropriate steps to minimize the likelihood of this potential effect,[10] such as altering new Section 5806 to clarify that domestic Excess Line carriers are subject to *all* of the provisions of the NYIL governing domestic insurers generally (and deleting the enumeration of specific applicable sections in Section 5806(a)(1) through (7)), with the limited exceptions set forth already in the bills.

Role of the Broker

Committee Comment: The new law should clarify the role of New York-licensed excess line brokers by, among other things, requiring coverage from a New York domestic excess line carrier to be placed by an excess line broker and mandating at a minimum the full panoply of disclosure currently required by regulation in New York (*e.g.*, the unavailability of insolvency fund protection).

Rationale: One of the hallmarks of the existing excess line regime is the central role of the excess line broker in placing coverage, a role contemplated by existing law. For instance, in New York, as you know, the statutory and regulatory requirements governing the excess line market are codified in Article 21 of the NYIL, which governs insurance intermediaries generally. This reflects the origin of the excess line market in the relationship between sophisticated purchasers of insurance (such as businesses and commercial organizations) and insurance professionals such as risk managers and brokers. The existing excess line regime is essentially a series of rules that a broker must comply with before securing, on behalf of the insured, coverage that is not readily available from admitted insurers. In exchange for the ability to place coverage with unlicensed, and thus less-rigorously regulated carriers, the law imposes obligations on the placing broker to, among other things, ascertain the appropriateness of the available carrier(s) for the risk in question,[11] to make numerous specific disclosures to the insured (including concerning the insured's inability to recover from New York's guaranty funds),[12] to pay the excess line tax[13] and to comply with recordkeeping requirements.[14]

The introduction of domestic excess line carriers as contemplated by the Excess Line Legislation removes this layer of consumer protection, protection that many small- and medium -size

[10] The NRRA prevents a state from "establish[ing] criteria for nonadmitted insurers" except "in conformance with" Sections 5A(2) and 5(C)(2)(a) of the National Association of Insurance Commissioners' Nonadmitted Insurance Model Act ("Model"), unless such state has adopted a nationwide compact on surplus line tax allocation. Dodd-Frank § 524(1). The Model provisions referred to require that in order to be eligible to underwrite surplus lines coverage in the adopting state, a carrier must be licensed to write such line in its domiciliary state and have minimum surplus of at least the greater of (i) the minimum in the adopting state (which the state itself may set) or (ii) $15 million. It is conceivable to us that the Excess Line Legislation would be deemed to exceed those Model provisions by imposing additional requirements on domestic excess carriers. Because New York has not adopted a nationwide compact, we cannot be certain that the Excess Line Legislation complies with Section 524 of Dodd-Frank to the extent it is not "in conformance with" those Model sections.

[11] 11 NYCRR § 27.13.

[12] 11 NYCRR § 27.17.

[13] NYIL § 2118(d).

[14] 11 NYCRR § 27.21.

businesses need, by expressly permitting "independently procured coverage".[15] In this regard we note that in Illinois's and New Jersey's domestic excess line statutes, coverage is still required to be placed through an eligible surplus lines broker,[16] meaning that the procedure for obtaining coverage from a domestic excess line insurer will approximate (if not duplicate) the existing procedure for obtaining coverage from out-of-state excess line carriers. This not only creates a desirable symmetry between the two but also maintains the role of the broker as a check on the inherently less-regulated nature of this sector. It is unclear to us how, as drafted, the New York Excess Line Legislation would ensure that the appropriate safeguards involved in obtaining excess line coverage from a domestic excess line carrier would be observed in the absence of broker involvement.[17] At least under existing law, where direct placement generally is permitted only if the policy is "principally negotiated, issued and delivered" outside the state,[18] it can be presumed that the insured knowingly and actively forgoes New York's protection. We note further that the only statement in the Excess Line Legislation providing guidance on such direct placements is the phrase "to the extent permitted by law."[19] This appears to beg the question of what standards and safeguards actually *would* apply to directly placed excess line coverage under the new law. In addition, it is unclear whether the phrase "to the extent permitted by law" was meant to ratify, or alternatively disturb, long-standing guidance on the types of activities an unauthorized insurer may or may not perform from a location within the state.[20]

Achieving a Single-Carrier Platform for 50-State Excess Line Writings

Committee Comment: The new law should specify that New York intends for domestic excess line carriers to be eligible excess line "nonadmitted" carriers in other states.

Rationale: The goal of making it more feasible for companies to write excess line risks using a single license for all 50 states is a sensible one. As noted in the sponsors' memorandum for the Senate version of the Excess Line Legislation, historically insurers would need to have at least two carriers writing excess lines in order to accommodate all 50 states because of the requirement in most states that an excess or surplus lines carrier be non-admitted. Furthermore,

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[15] We assume that this term is meant to have the definition ascribed to it in the NRRA. We would suggest that this be made explicit in the Excess Line Legislation and similarly that the term "home" state as used in the Excess Line Legislation be defined by reference to the NRRA to avoid any ambiguity.

[16] N.J. Stat. § 17:22-6.69b(b); § 215 ILCS 5/445a(b).

[17] If New York followed New Jersey and Illinois in this regard by requiring that coverage from a domestic excess line carrier be placed through a licensed excess line broker, this would eliminate the need for proposed NYIL Section 5803(d), which provides that transactions under new Article 58 "shall not constitute doing an insurance business" for purposes of Section 1102(a). If a domestic excess line carrier were required to write business only through a licensed broker pursuant to the existing surplus lines law, the existing exclusion in Section 1101(b)(2)(F) could be relied on to immunize domestic excess line transactions from Article 11 requirements. We believe that the inclusion in new Article 58 of an express exclusion to Article 11 is potentially confusing and could be more narrowly tailored if necessary.

[18] NYIL § 1101(b)(2)(E).

[19] Proposed NYIL § 5802(a)(2), § 5802(b)(1)(B).

[20] Furthermore, the new law should expressly indicate under what (if any) circumstances an excess line broker acting as a consultant in an otherwise independent procurement is subject to the New York excess line regime as set forth in NYIL Sections 2015 and 2118.

if New York were to become the domicile of new excess line carriers writing excess line coverage on a 50-state basis, this development would likely, as the sponsors' memorandum explains, spur economic growth in this state.

However, the Excess Line Legislation may not be sufficient to achieve the goal of allowing a single entity to write excess line coverages nationwide. This is because, by its terms, a "domestic excess line insurer" is not an "admitted" insurer in New York or elsewhere.[21] As you are aware, excess line coverage in a given state generally must be underwritten by an excess line carrier admitted in at least one other state or jurisdiction. It is not clear to us that a domestic New York entity formed pursuant to the legislation would be considered "admitted" for such other state's purposes. Indeed, there may be no way that New York law can bind other states to recognize a New York domestic excess line carrier. To the extent that the Excess Line Legislation purports to so bind another state, it may be preempted under the NRRA.[22]

The legislature might consider amending proposed Section 5802(b), which states that a domestic excess line carrier is "not an authorized insurer as defined in Section 107 of" the NYIL, by adding a proviso at the end, such as the following:

> "*provided, however, that such status shall not be deemed to exclude such a Domestic Excess Line Insurance Company from surplus or excess line eligibility in any other state, and, for purposes of such eligibility, where such other state's requirements include the condition that a carrier be admitted in a state, the New York Domestic Excess Line Insurance Company may, to the extent not prohibited by Section 522 or 524 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, be deemed 'admitted' for such purpose.*"

Effect on Admitted Market

Finally, without suggesting a specific textual comment on this point, we note the possibility that a more robust New York state excess line sector could have an adverse effect on the capacity and availability of admitted coverage within the state. As noted above, we believe the motivation for excess line insurance in the first place is to provide options for those with hard-to-place risks. It was not meant to be, nor should it be encouraged to become, a general substitute for the admitted market. To the extent that existing capacity chooses to write business on a nonadmitted basis, admitted capacity could be diminished. Of course, expanding capacity of all kinds to meet demand is the best outcome. Still we would encourage the legislature and the DFS, if the Excess Line Legislation is adopted, to monitor the nonadmitted and admitted markets in the state going forward to make sure that any "crowding out" of the admitted markets is noticed and examined. The goals of the Excess Line Legislation would be frustrated if new Article 58 caused a disruption in the availability to New Yorkers of more standard, less sophisticated coverages.

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[21] Proposed NYIL § 5802(b)(1).

[22] The NRRA provides that the placement of nonadmitted insurance is subject exclusively to the regulation of the "home" state of the insured and that any law purporting to apply to nonadmitted insurance issued to an out-of-state insured "shall be preempted with respect to such application." Dodd-Frank § 522(a), (c).

In this regard, the legislature may wish to consider requiring the Superintendent, after a specified period of time in which the Excess Line Legislation has been in effect (*e.g.*, one or two years), to assess and report on the law's impact on the availability and affordability of insurance in the state's admitted markets.

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The Committee would be delighted to discuss with you or your staffs any of the foregoing points or any other matters in connection with the Excess Line Legislation.

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