



## National Association of Professional Surplus Lines Offices, Ltd.

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Richard M. Bouhan  
Executive Director

April 8, 2010

Mr. John W. Bauer  
Chief Counsel, Regulatory Affairs  
National Association of Insurance Commissioners  
2301 McGee Street, Suite 800  
Kansas City, MO 64108

### RE: Kentucky NARAB Checklist

Dear Mr. Bauer:

NAPSLO would like to comment about the Kentucky NARAB Working Group Reciprocity Checklist responses. The responses indicate that an underlying non-resident P&C license is required as a precondition for obtaining a non-resident surplus lines broker's license. We believe the legislature intended to address this issue in Section 304.10-120 where it outlined the requirements for obtaining a non-resident surplus lines agent's license:

☛ [Subtitle 10](#). Surplus Lines ([Refs & Annos](#))

➔ **304.10-120** Licensing of surplus lines brokers; reciprocity; termination

(1) Any person who:

(a) Is a resident of Kentucky or is a nonresident who is not eligible to be issued a license in accordance with [KRS 304.9-140](#);

(b) Holds an agent license with lines of authority for property and casualty; and

(c) Is deemed by the executive director to be competent and trustworthy with respect to the handling of surplus lines;

may be licensed as a surplus lines broker.

(2) Application for the license shall be made to the executive director on forms as designated and furnished by the executive director.

(3) The license fee shall be as specified in [KRS 304.4-010](#).

(4) The license and licensee shall be subject to the applicable provisions of Subtitle 9 of this chapter.

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(5) Notwithstanding subsection (1) of this section, on or after July 1, 2002, an applicant licensed as a surplus lines broker in the applicant's home state may be issued a nonresident surplus lines broker's license in Kentucky if the applicant's home state issues surplus lines broker licenses to Kentucky residents on the same basis.

(6) If the resident surplus lines broker fails to maintain his or her agent license with lines of authority for property and casualty, the surplus lines broker license shall terminate and shall be promptly surrendered to the executive director without demand.

The legislature intended to address the Graham-Leach-Bliley requirements by indicating that a non-resident surplus lines broker can obtain a license by compliance with Section (5) of this statute. Section (5) of the statute requires a license in the home state, and reciprocal licensing. It does not require an underlying P&C license from Kentucky. We believe Section (5) should have resulted in the Kentucky response to Question 4.a being that a non-resident surplus lines broker is not required to have an underlying P&C license.

We believe the legislature intended to address non-resident licensing for surplus lines brokers and that they did not intend to require a non-resident P&C license as a precondition for a non-resident surplus lines license. If the survey response to Question 4.a. is "no" then there is no reason to respond to the other parts of Question 4.

A separate question in Part 4 of the survey is whether the surplus lines broker is required to perform a diligent search. It may be unnecessary for the purposes of the NARAB Working Group to address the diligent search issue since the state legislature has already decided that an underlying non-resident P&C license is not needed for a non-resident surplus lines license. Nevertheless, NAPSLO would like to comment on Kentucky's response to question 4 c because we believe that a surplus lines license is required to perform a diligent search only when the surplus lines broker is the only licensed producer in the transaction. The question and the response are as follows:

Is the surplus lines producer required to perform the diligent search of the admitted market in your state?

Yes X No \_\_\_ Citation: KRS 304.10-040 (2)

Kentucky Statutes Section 304.10-040 (2) provides that a surplus lines licensee can obtain surplus lines insurance from non-admitted insurers if:

(2) the full amount of insurance required must not be procurable, after diligent effort has been made to do so , from among the insurers authorized to transact and actually writing the kind and class of insurance in this state, and the amount of insurance exported shall be only the excess over the amount procurable from authorized insurers.

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A diligent search is required, as it is in almost all states, but we do not believe that the statute required that a surplus lines wholesale broker to conduct the diligent search. The statute requires that a diligent search is made, but does not indicate if the retail agent or the wholesale broker should conduct the diligent search. We believe the statute was worded this way to accommodate both production systems.

The statutory scheme specifically allowed the surplus lines broker to accept business from the retail broker and to compensate the retail broker for the business:

**304.10-150 May accept business from agents**

A licensed surplus lines broker may accept and place surplus lines business for any insurance agent licensed in this state for the kind of insurance involved, and may compensate the agent therefore.

The wholesale surplus lines broker would normally rely upon the diligent search conducted by the retail agent and the statutory scheme specifically permits this use of the wholesale production system. The retail agent is typically an independent insurance agent. The retail agent is the expert in the admitted markets. The surplus lines wholesale broker is an intermediary between the retail agent and the surplus lines company. The surplus lines wholesale broker is an expert in surplus lines markets and would have little or no contacts in the admitted markets. It would be an unnecessary waste of time for the surplus lines wholesale broker to conduct a second diligent search of the admitted markets, because the retail agent has already done so.

There are retail surplus lines brokers that directly access the surplus lines markets. Retail surplus lines brokers would conduct a diligent search of the admitted markets. They are the only broker in the transaction and the only broker who could conduct the diligent search. By contrast, in a wholesale production system, the retail broker is in the best position to conduct a diligent search of the admitted markets.

The Kentucky "affidavit for surplus lines insurance transactions" authorizes a diligent search by the retail broker. It specifically states:

I, or the KY licensed P&C agent, have/has endeavored to secure this insurance from insurers licensed in Kentucky and, having been rejected, have advised the assured that his/.her coverage is being insured by a surplus lines carrier which is not licensed to do business in Kentucky.

We believe the affidavit shows that Kentucky intended to permit the wholesaler to rely upon the diligent search conducted by the licensed retail insurance broker.

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In a transaction involving both a retail broker and a surplus lines wholesaler, we believe the role of the surplus lines market as a supplemental market is better served if the retail broker is allowed to conduct the diligent search. For example, if a doctor had multiple claims during the year, the doctor may not realize there is no admitted market for his/her malpractice coverage until his retail agent has made a submission to the admitted markets. Only after the risk is declined by the admitted markets would the retail agent contact the surplus lines broker to make a submission in the surplus lines markets. The doctor could not know in advance that his coverage would be declined by the admitted markets. Since the surplus lines market is intended to be a supplemental market, there are good reasons for the retail broker to search the admitted markets prior to contacting the surplus lines wholesaler. It would be impractical for the surplus lines wholesaler to conduct a second diligent search of the admitted markets prior to placement in the surplus lines markets.

We believe it is in the best interest of the states, the NAIC, and NAPSLO to have as many states certified as reciprocal as possible. Great strides have been made in the area of reciprocal licensing and in this would be one more step in the direction of reciprocal licensing. If there is anything NAPSLO can do to further this overall objective, please let me know.

Yours truly,

A handwritten signature in cursive script that reads "Steven P. Stephan".

Steven P. Stephan, J.D., CPCU, ARe  
Director of Government Relations