



National Association of Professional Surplus Lines Offices, Ltd.

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Richard M. Bouhan
Executive Director

January 19, 2010

Mr. Jason McCartney
Nebraska Department of Insurance
941 O Street, Suite 400
Lincoln, NE 68508

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

**RE: Nebraska NARAB Working Group Reciprocity Checklist
NAIC NARAB Survey Responses**

Dear Messrs. McCartney and Bauer:

I am writing from the National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) regarding Nebraska's responses to the NAIC's NARAB Working Group Reciprocity Checklist (enclosed). NAPSLO appreciates the time you devoted to this project as licensing reform is a major initiative of the NAIC and an issue that the U.S. Congress continues to focus on.

The reason for the NARAB project is to determine how many states are compliant with the requirements for reciprocal licensing contained in Gramm-Leach-Bliley (GLB). Specifically, at least 29 states were to implement reciprocal licensing by 2002 or the National Association of Registered Agents and Brokers would come into existence. A version of the NARAB bill was introduced in Congress again in 2007 and 2008. At about the same time, the NAIC initiated a project under the auspices of the "NARAB Working Group" to determine how many states were compliant with the GLB requirements.

Nebraska has construed Section 44-5503 to require an underlying P&C license as a prerequisite for a surplus lines broker's license. The NAIC's interpretation is that to be GLB compliant Nebraska would need to repeal the requirement for an underlying P&C license, at least to the extent it applied to non-resident surplus lines wholesale brokers. There is an exception to this rule. Under the NAIC analysis, a non-resident surplus lines wholesale broker could be required to obtain a Nebraska non-resident P&C license if they were required by state law to complete a diligent search of the admitted markets prior to accessing the surplus lines markets. The theory is that the surplus lines wholesale broker could not complete a diligent search of the admitted markets unless he or she possessed a P&C agent's license. Conversely, if the surplus lines wholesale

broker is not legally obligated to conduct the diligent search, then no underlying P&C agent's license should be required.

We believe Nebraska could amend Section 44-5503 so that it no longer requires a non-resident P&C license for non-resident surplus lines wholesalers because Nebraska does not specifically require a diligent search to be conducted by the surplus lines broker. Significantly, Nebraska does not require a risk to be declined by an admitted market prior to accessing the surplus lines markets. Nebraska requires only that the licensee have no knowledge on how the risk could have been placed in the admitted markets and Nebraska does not prohibit the surplus lines wholesaler from relying upon the retail insurance broker's attempts to place the business in the admitted markets. In NAPSLO's opinion, Nebraska could amend its law to become GLBA compliant because the "diligent search" required by Nebraska would not require a P&C agent's license.

The GLB issue that impacts surplus lines brokers is that a substantial segment of the surplus lines market operates through a wholesale production system. In other words, the surplus lines wholesale brokers act as intermediaries between a retail insurance agent (typically and independent insurance agent) and the surplus lines insurance company. Surplus Lines Wholesale Brokers do not sell insurance directly to an insured. They market their brokerage services to the retail insurance agent.

One requirement of the surplus lines regulatory system that is almost universal is that the surplus lines markets cannot be used if admitted insurers (markets) are willing to underwrite the risk. Some "diligent search" of the admitted market is required in all but a few states. Surplus lines wholesale brokers would not undertake a diligent search of the admitted markets because the retail agent would have already done so. In fact the retail agent must share a commission with the wholesale broker, so there is a disincentive to bring the wholesale broker into the transaction unless they are certain there is no admitted market. In addition, the premium is typically higher, the taxes are typically higher and the compliance burden is typically greater in the surplus lines market.

Nebraska Section 44-5510 seems to acknowledge that the surplus lines wholesale broker is not to conduct the diligent search in providing:

If an applicant for insurance is unable to procure such insurance as he or she deems reasonably necessary to insure a risk exposure from an admitted insurer, such insurance may be procured from a nonadmitted insurers upon the following terms and conditions:

- 1) The insurance shall be procured from a surplus lines licensee
- 2)

- 3) Not later than 30 days after the effective date of insurance, the insured shall provide, in writing, his or her permission for such insurance to be written in a nonadmitted insurers . . .
- 4) Compliance with Section 44-5511 (which requires the licensee to swear that to the best of their knowledge . . . the licensee could not reasonably procure such coverages from an admitted insurer).

Nebraska statutes initially requires the applicant for insurance to indicate that admitted markets cannot be found and then asks the “licensee” to swear that an admitted insurer could not be found. Significantly it does not require the risk to have been formally declined by the admitted markets. Many states specifically require that a certain number of admitted markets specifically decline to underwrite the risk. This is known as a “declination.” In order to obtain a declination, it would appear that a P&C license would be required because someone would need to obtain an application from an insured and make a submission to the admitted companies. Because Nebraska does not require a declination, it would appear that there would not be a reason to require the wholesale broker to obtain a P&C agent’s license (except for 44-5503).

In the vast majority of states there would be no reason for the non-resident surplus lines wholesaler to also have a non-resident P&C agent’s license. Wholesalers don’t generally perform a diligent search and don’t generally have access to admitted insurers. Wholesalers don’t sell insurance to insured’s, and they only act as intermediaries between the retail agent and the surplus lines company. A wholesaler’s customer is the retail insurance agent. If a surplus lines wholesale broker were to sell insurance directly to insureds, they would be competing with their customers - the retail agent. A non-resident surplus lines broker’s license should be all that is needed to act as a non-resident surplus lines wholesaler.

Some large, national surplus lines brokers (not wholesalers) transact business as retailers. Retail surplus lines brokers do sell, solicit and negotiate insurance directly to insured’s. Retail surplus lines brokers don’t act as wholesalers. They would compete with the retail agents, so the retail agent would be reluctant to bring a retail surplus lines broker into a transaction. Non-resident “retail” surplus lines brokers would need a non-resident P&C license (in most states) because they need to be able to obtain declinations from admitted carriers. A retail surplus lines broker would need a P&C license to obtain the application, act as a broker in making a submission to the admitted company and to obtain a declination to complete the “diligent search.”

Nebraska is different in that no “declination” is needed from the admitted markets. The law merely requires the “licensee” to report that “to the best of the licensee’s knowledge and belief the licensee could not reasonably procure such coverages from an admitted insurer.” The law does not require a declination from an admitted carrier like other states.

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The term "licensee" in the Nebraska statute could be read to mean the surplus lines licensee, but the general rule is that the states do allow a diligent search to be conducted by the retail agent who is obviously also a "licensee." Because Nebraska does not require a declination, the reason for requiring a surplus lines wholesaler to obtain a P&C license does not exist. It would appear that Nebraska could amend Section 44-5503 so that the surplus lines wholesaler was not required to obtain a P&C agents license to become GLB compliant.

Nebraska law could also be clearer in acknowledging the normal functioning of this wholesale system where an independent agent (without a surplus lines license) may act as a producing broker in a surplus lines transaction with a licensed surplus lines wholesale broker. Nebraska's documentation explains the functioning of the wholesale system but the statutes are not as clear as they could be. All but a few states specifically acknowledge that the diligent search can be undertaken by the retail P&C agent and the surplus lines wholesaler may rely upon the efforts of the retail agent. This is consistent with market realities in that many times an insured with a hard-to-place risk does not know in advance that there is no admitted market for their insurance when they start to purchase insurance. For example, if a doctor has adverse claims experience during the year, he or she may discover there is no admitted market at renewal. The doctor could not know in advance that it would be necessary to contact a surplus lines broker. Only when the retail agent advises the doctor there is no admitted market does it become apparent that a surplus lines broker must be brought into the transaction. If Nebraska were to require the non-resident wholesale broker to undertake a diligent search, there would be two diligent searches of the admitted market for each risk, which is obviously a waste of time, particularly when the first one was conducted by an expert in the admitted markets (typically an independent insurance agent).

We would urge Nebraska to issue a bulletin to clarify that a surplus lines wholesale broker is able to rely upon the diligent search conducted by the retail agent. It would be a bureaucratic waste of time to require the surplus lines broker to conduct a diligent search of the admitted markets when the retail agent has already concluded there is no admitted market.

Nebraska has issued a document called "Surplus Lines Policies" (enclosed). It provides:

"Your agent or broker was unable to find the coverage you requested among companies licensed in Nebraska but was able to provide coverage from an eligible surplus lines company" and "your agent or broker may have worked with a licensed excess or surplus lines broker in securing your policy."

The Nebraska Insurance Department is aware that the wholesale production system exists for situations where the retail agent is unable to find insurance for the insured and

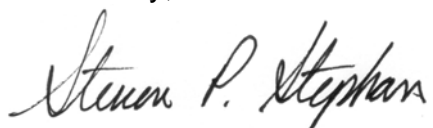
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then brings the surplus lines wholesale broker into the transaction. There would be no logical reason for the surplus lines wholesale broker to conduct a search of the admitted markets when the retail independent agent was unable to find coverage. The retail (independent) agent is the one with expertise in admitted markets. The surplus lines wholesaler is the broker with expertise in the surplus lines markets. The surplus lines wholesaler may not have any appointments with admitted companies because they do not produce admitted business. We do not believe that Nebraska intended for the surplus lines wholesale broker to conduct a second diligent search, but given the wording of the statute believe it would be prudent to clarify the point with a bulletin.

NAPSLO believes it is in the best interest of the state to clarify Section 44-5503 and issue a bulletin to clarify this important distinction involving the wholesale distribution system. I have enclosed a chapter from the AICPCU textbook "Surplus Lines Insurance Principles and Issues." The chapter contains a lengthy description of the surplus lines wholesale distribution system. I have also enclosed some affidavits, bulletins and regulations where other states have clarified that the surplus lines wholesaler may rely upon the diligent search performed by the retail agent. Many states use the term "producing broker" to describe the retail insurance broker.

I appreciate the opportunity to comment. If you would like to discuss it further, please contact me. If necessary, we could be available for an in-person meeting to discuss this important matter. NAPSLO is located in Kansas City and we could easily travel to Nebraska for a meeting if necessary.

Yours truly,

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

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