



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

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Richard M. Bouhan  
Executive Director

August 26, 2010

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

### RE: Texas NARAB Questionnaire

Dear Mr. Bauer:

NAPSLO would like to comment about the Texas NARAB Working Group Reciprocity Checklist responses. The responses indicate that an underlying non-resident P&C license is not required as a precondition for obtaining a non-resident surplus lines broker's license. We believe, in practice, the state is presently requiring the underlying license P&C license. The practice of requiring the P&C license as a prerequisite for a non-resident surplus lines license would call into question the certification of Texas as GLBA compliant. Based upon the information provided to NAPSLO, the answer to question 4.a is not consistent with the practice in the state. If our information is correct and the underlying license is presently being required, then some further evaluation of the reciprocity certifications may become necessary.

The state intended to address the issue of non-resident surplus lines broker licensing in section 15.3. where it outlined the requirements for obtaining a non-resident surplus lines license:

#### § 15.3. Licensing of Surplus Lines Agents

(a) Persons performing any of the following surplus lines insurance activities are required to have a surplus lines license:

(1) supervising unlicensed staff engaged in activities described in subsection (b) of this section, except that supervision of staff may be conducted through the supervision of the staff's unlicensed supervisors;

(2) negotiating, soliciting, effecting, procuring, or binding surplus lines insurance contracts for clients or offering advice, counsel, opinions, or explanations of surplus lines insurance products to agents or clients beyond the scope of underwriting policies or contracts, except for a general lines property and casualty agent making a referral of surplus lines business to a surplus lines agent or agency that then completes the surplus lines transaction; or

(3) receiving any direct commission or variance in compensation based on the volume of surplus lines premiums taken and received from, or as a result of, another person selling, soliciting, binding, effecting, or procuring surplus lines insurance policies, contracts, or coverages, except for a general

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lines property and casualty agent making a referral of surplus lines business to a surplus lines agent or agency that then completes the surplus lines transaction.

(b) The following activities in a surplus lines agency do not require a surplus lines license if the employee does not receive any direct commission from selling, soliciting, binding, effecting, or procuring insurance policies, contracts or coverages, and/or the employee's compensation is not varied by the volume of premiums taken and received:

.....

(d) Before any surplus lines agent's license shall be issued, the following must be submitted by an applicant seeking a surplus lines license:

(1) an appropriate, fully completed written application; and

(2) the fee specified by § 19.801 and § 19.802 of this title (relating to General Provisions Regarding Licensing Fees and License Renewal and Amounts of Fees).

(e) Texas resident applicants and nonresident applicants who do not hold a surplus lines license in their state of residence or whose state of residence does not license Texas residents on a reciprocal basis as determined by the department, shall meet all licensing requirements as set forth in the Insurance Code Chapter 981. Nonresident applicants under this section shall also comply with the [Insurance Code § 4056.051](#).

(f) Nonresident applicants holding a surplus lines license in good standing in the agent's state of residence and meeting the requirements of the [Insurance Code § 4056.052](#) shall meet all the licensing requirements of the Insurance Code Chapter 981 to the extent that such Chapter 981 requirements are not waived by the commissioner under § 4056.055.

(g) Each surplus lines license issued to an agent shall be valid for a term expiring two years after the date of issuance or as otherwise established by the commissioner under the [Insurance Code § 4003.001](#). The license may be renewed by submitting a renewal application and a non-refundable license fee as specified by § 19.801 and § 19.802 of this title.

Section **§ 4056.052** provides as follows:

(a) The department shall issue a license to an applicant under this chapter if:

(1) the applicant holds a license in good standing as an agent in the applicant's state of residence; and

(2) the applicant's state of residence will grant a nonresident agent license on a reciprocal basis to a resident agent of this state.

(b) The department may issue a reciprocal nonresident agent license to an applicant if the authority granted by the license issued by the applicant's state of residence is generally comparable to the authority granted by a license issued by this state.

The legislature intended to address the Graham-Leach-Bliley requirements by indicating that a non-resident surplus lines broker can obtain a license if the broker is licensed in

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the applicant's state of residence and the applicant's state of residence will grant a non-resident license on a reciprocal basis. Section (1) of the statute requires a license in the home state. It does not require an underlying non-resident P&C license from Texas. We believe Section (1) is consistent with Texas' response to Question 4.a but not consistent with the applied practice in the state.

Question 4.c. asks if the surplus lines producer is required to perform the diligent search of the admitted market in your state. Texas answered "yes" to question 4.c. I do not believe Texas law requires the surplus lines producer to conduct a diligent search if a diligent search was already conducted by the retail producer. Section 15.3.(a)(3) allows a referral from a retail agent. We do not believe that the state intends for a second, duplicative, diligent search to be conducted. We believe the state, like almost all other states, believes that the surplus lines broker should verify that a diligent search was conducted. We do not believe that the state intends for a surplus lines wholesaler to conduct a diligent search if the retail agent has already verified there is no admitted market for the risk.

Texas statutes provide:

**§ 981.004. Surplus Lines Insurance Authorized**

(a) An eligible **surplus lines** insurer may provide **surplus lines** insurance only if:

(1) the full amount of required insurance cannot be obtained, after a **diligent** effort, from an insurer authorized to write and actually writing that kind and class of insurance in this state;

(2) the insurance is placed through a **surplus lines** agent;

The code provides for a diligent search but does not prohibit the surplus lines wholesaler from relying upon the diligent search conducted by the retail agent.

The wholesale surplus lines broker would normally rely upon the diligent search conducted by the retail agent. The retail agent is typically an independent insurance agent and typically does not have a surplus lines broker's license. 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.

There is a second production model where the retail surplus lines brokers directly access the surplus lines markets without a wholesaler. 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. A retail surplus lines broker would need both a P&C license and a surplus lines broker's license.

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Many states require the surplus lines broker to execute the affidavit even if the diligent search was conducted by a retail broker. Some states also require the retail broker to execute an affidavit regarding the diligent search. The states that require the wholesaler to execute the affidavit do not typically prohibit the surplus lines wholesale broker from relying upon the diligent search already conducted by the retail producer.

The question could have been more specific in distinguishing the requirements for a retail surplus lines broker and a wholesale surplus lines broker. We believe the answers to the question 4 are accurate in the context of a surplus lines retail broker because a retail surplus lines broker must conduct a diligent search. A non-resident retail surplus lines broker would need an underlying P&C license in order to conduct a diligent search. We believe that a non-resident wholesale surplus lines broker would not need an underlying P&C license because the diligent search was already conducted by the retail producer.

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