

The E&S Empire Express



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ELANY Extender Legislation Enacted

ELANY is pleased to announce that both houses of the legislature passed Senate Bill §3819-A, and Governor Pataki signed this legislation into law in mid June. The bill enacted as Chapter 90 of the Laws of 2005 extends ELANY's operating authority for four years through June 30, 2009.

ELANY's Executive Director, Daniel Maher, expressed his gratitude for the support received from PIWA, NAPSLO and other associations in promoting the passage of this extender legislation. Moreover, the understanding and support of Senator Seward and the Senate Insurance Committee, Assembly Committee Chairman Pete Grannis, and the Assembly Insurance Committee and Governor Pataki actively represented by his counsel, Chris McCarthy, demonstrate an appreciation of the value of the services ELANY brings to the E&S marketplace.

Electronic Filing—Where art thou?

One member tells us—filing original documents snail mail is so "80s", so where is ELANY with electronic filing? The answer is electronic filing is coming soon and will occur in incremental steps. While the insurance department still requires ELANY to process original policy documents, ELANY is in the final stages of negotiating material changes with the department. If all goes as expected, changes will occur before year end 2005, including approval to receive non-original policy documents. This means ELANY intends to start returning documents by emailing members a link to a secure site from which stamped documents can be retrieved. This will reduce return time by an average of two days.

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Processing transactions completely electronically is approximately 18 months away. ELANY is in the process of replacing its legacy database system with a new database designed to be one major component of a fully electronic system. When the new system is implemented, members will be able to submit transactions by completing on line affidavits signed electronically with scanned copies of the necessary policy and/or other documents. Similar to the system now employed by the Surplus Lines

Stamping Office of Texas, submissions can be made by completing transactions at an internet site. Additionally, assuming approval from the New York State Insurance Department, brokers will be able to submit transactions programmatically by dumping data into ELANY's system using XML or ASCI formatted data.

Once completed, members will have the choice of mailing paper transactions to ELANY or submitting them electronically by either method referred to above.

E&S Broker License and the Bond Requirement

This past session, the Texas legislature repealed the requirement that surplus lines brokers post a bond protecting the State's right to collect surplus lines taxes in the event of broker default. The Texas insurance department had previously waived the bond requirement for nonresident licensees in order to comply with the reciprocal licensing provisions of the Gramm Leach Bliley Act.

On first glance, to some, this may seem like yesterday's news, but in reality the repeal of these bond requirements represents a substantial positive impact for E&S brokers.

NAPLSO, ELANY and a number of state surplus line associations and stamping offices led the charge to repeal these requirements which were both costly and a major administrative burden for brokers in processing, maintaining and renewing various state E&S licenses.

The associations which supported the repeal and/or waiver of these bond requirements recognized the savings would ultimately be **tens of thousands of dollars** to multi-state E&S brokers while simultaneously eliminating the bureaucratic burden of processing the bond applications and bonds in conjunction with the license applications.

Some states have retained the bond requirements. You will probably find that these states have the most difficult and expensive application requirements in the country.

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Model Insurance Laws and the National Conference of Insurance Legislators (NCOIL)

The National Conference of Insurance Legislatures (NCOIL) is an active association consisting of 33 state legislatures whose individual legislators from the Senate and Assembly Insurance Committees hear testimony, debate insurance issues and adopt model laws. At the most recent NCOIL meeting, 358 registered attendees participated including 80 legislators, 10 from New York.

In a number of instances, NCOIL model laws have been widely adopted by a number of states creating a greater level of uniformity across state lines. A recent example of this is NCOIL's Model Act regarding Use of Credit Information. This bill has been adopted with some variations in a substantial number of states. ELANY attends the NCOIL conferences which are scheduled approximately every four months.

The various Model Acts which are adopted by NCOIL are reviewed from an E&S perspective to determine whether they ought to apply to the E&S industry and if so, to what extent they should apply.

For example, the Model Act regarding Use of Credit Information applies to "authorized insurers" and does not limit E&S insurers' use of credit scoring as a rating factor for personal lines business. This leaves the E&S market free to rate and price hard to place risks and does not impede the E&S market from innovating. Similarly, a recent Model Act adopted by NCOIL on Friday, July 8, 2005, restricts the use of past loss histories such as CLUE reports when underwriting homeowners and other personal lines residential property. This model too, applies to authorized insurers only. Again, this shows recognition on the part of those who participate at NCOIL that the E&S market should not be discouraged or hampered from writing risks that already constitute those that are most difficult to underwrite.

While NCOIL's models generally have been collaborative efforts among colleagues from the legislature, industry and insurance departments, it is important to recognize that these models can potentially be amended and adopted by any state legislature.

New York adopted a variant of the NCOIL credit scoring model which excluded the definition of "authorized insurer." Nevertheless, the model will not apply to E&S insurers because §2802 of the Insurance Law applies to insurers "doing an insurance business" which in New York, is synonymous with the term "authorized insurer."

Therefore, it is important to track these bills in your home state legislature to make sure the E&S industry is not inadvertently swept into the requirements of such legislation.

New York Board of Fire Underwriters & The New York City Fire Patrol

For years, members inquired about the assessments pursued by the NY Board of Fire Underwriters (NYBFU) which arrive every March as sure as the swallows return to San Juan Capistrano.



"Do we owe these assessments?" "Does the Fire Board have the right to assess us", excess line brokers would ask.

ELANY for a number of years would explain the insurance department's position that excess line brokers were required to report fire premiums on excess line policies placed on properties in the five counties of New York City, but that the excess brokers did **not** owe the assessments. The insurance department asserted the assessments were owed by excess line insurers although little evidence exists that excess line insurers paid these assessments.

ELANY encouraged excess line brokers to remit any assessment **to the extent** the excess line broker charged and collected them from insureds using a total cost form to bill the charge.

In the last few years, ELANY became aware of aggressive collection tactics undertaken by the NYBFU including what ELANY believed to be misrepresentations in the assessment letters asserting excess line brokers owed the assessment whether they were collected from the insureds or not. ELANY took issue with this and other aggressive tactics in discussions with the NYBFU's counsel.

While those discussions proved fruitless, ELANY joined with an Ad Hoc Group of ELANY members, trade associations and insurers to analyze the assessments and the services provided by the NYBFU.

The Ad Hoc Group, in short, noted that the NYBFU was created in the 1800's by the New York State legislature. It assumed the responsibilities of managing the New York City Fire Patrol over 100 years ago. The Fire Patrol in the years before electricity and the combustion engine, patrolled New York City streets to locate and report fires so firefighting equipment arrived on the scene quickly. Today, the fire patrol lays tarps over personal property (computers, cubicles) in commercial space in the event of fire.

For these services, a 1% charge on all New York City fire premium is assessed. That equates to a budget of approximately \$10,000,000 a year.

The Ad Hoc Group noted with great interest that the NYBFU's enabling statute requires a vote every two years by insurers paying the assessments as to whether the New York City Fire Patrol should be continued. This vote will be called in January 2006.

Members of the Ad Hoc Group have raised numerous questions with the NYBFU, the responses to which ranged from inadequate to unsupported by adequate business records. In meetings with the current

leadership of the NYBFU, information regarding the number of fires where tarps were actually laid and how loss mitigation savings were calculated were not available. Some of the insurers participating in the Ad Hoc Group have become proactive. New directors, in some instances, have been appointed as Directors to the board of directors of the NYBFU. This newly reconstituted board of directors is now actively involved in assessing the Fire Patrol's day to day functions.

In the final analysis, the need for these tarp laying services and the value of such services have been called into question. Many licensed insurers, which bear the brunt of these changes, pay but receive no benefit. For example, major auto writers and homeowners insurers pay for services they never receive.

At ELANY, we encourage all of our members to advise insurers to **VOTE** in January.

This is one of the few assessments insurers have the ability to control or terminate forever. The assessments should not continue due to inertia or inattention.

Broker Compensation Update

Not much to say here really. It came in with a bang and became a small storm, not a hurricane.

When the hysteria died down, cooler heads prevailed. A realization came about that existing laws provided meaningful redress to the misconduct that was discovered. As such, a plethora of new laws did not come about.

The NAIC and NCOIL both moved swiftly to frame model laws relating to broker compensation. In the end, these entities deserve credit for recognizing that disclosure was the real issue, not fiduciary duty and not a prohibition on contingent compensation. Moreover, the efforts of AAMGA and NAPSLO resulted in an appropriate exemption for wholesalers and MGAs in these models since they do not deal directly with insureds.

In the end, Connecticut and Texas passed disclosure laws with wholesaler and surplus line exemptions. Connecticut requires insureds' written consent when compensation is paid by both the insurer and insured.

In California, the commissioner's efforts both legislative and regulatory were turned back, at least for now. Arkansas passed legislation and Oregon also addressed the compensation issue.

In New York, while legislation was introduced in the Assembly, Senator Seward made clear he did not see a need for legislation regarding the small town brokers; and if any legislation was in order, it would go to disclosure only. While no legislation was passed, the New York department is working on a disclosure regulation and PIWA is working to obtain a wholesaler exemption in the proposed regulation.

In the end, the largest impact caused by the problems uncovered by the Attorney General are the changes at the alphabet houses where contingencies are forbidden and wholesaler/subsidiaries are for sale. Will the swearing off of contingents by the big brokers force changes to compensation terms all across the marketplace? The answer to this question is not yet known.

Do's & Don'ts in the Excess Line Market

- Do** File a tax return for each year you are a licensed excess line broker. The insurance department assesses you for failing to file a return even when you owe no taxes.

- Do** Refile corrected items when they are suspended and returned to you unstamped. The insurance department has shown great interest in brokers with long lists of uncorrected suspense items.

- Do** File final declaration pages and cover notes even when the binder was stamped months earlier. The insurance department takes an interest in transactions where no final policy was stamped. Since delivering an excess line policy without the ELANY stamp violates the law and exposes you to E&O claims, you should be interested in having final policies stamped too.

- Don't** Allow out of state entities which are not licensed in New York to tell you what is legal in New York. Many times, particularly where purchasing groups or tax allocated risks are involved, excess line brokers explain how no tax is owed because the manager of the PG or the excess line insurer said so. Be aware that you are the licensee and the duty to comply on purchasing group business or the duty to allocate in accordance with the law is your legal responsibility.

- Don't** Place business with ineligible carriers and call the account a direct procurement.

- Don't** Place a risk for a tax exempt entity and file it as a direct procurement to allow the insured to use its tax exempt status so as not to pay the tax at all. This could be looked upon as a tax fraud on the part of the excess line broker.

- Do** Play it straight. There are many people who had great careers in this industry who probably now lament the corners they cut and the careers they lost.

By Syndicate Reporting on Lloyd's Policies

ELANY has initiated a proposal to develop a direct reporting link between Lloyd's and ELANY for syndicate participations on each policy.

ELANY's efforts have included discussions with Lloyd's, the New York State Insurance Department and several other state stamping offices which capture individual subscription participations for each Lloyd's policy.

While the effort is in its early stages, if successful, excess line brokers will only need to report Lloyd's policies as a Lloyd's policy with a unique identification number. The rest of the information would be obtained by ELANY directly from Lloyd's.

We'll keep you apprised of further developments.

On-Line Affidavit System

Use of ELANY's on-line affidavit system by both excess line brokers and retail producers continues to grow. Brokers have found that the system eliminates keystrokes, absolutely prevents a number of errors frequently found in handwritten affidavits and puts all necessary codes right at your fingertips.

When ELANY begins emailing a link to the excess line brokers at which stamped documents can be retrieved (beginning in December), that link would be through ELANY's on-line affidavit system. You'll need an ID and password.

Take the system for a test spin. Access the instruction module on the ELANY website and contact Brian Persaud, ELANY's IT Manager (646-292-5582), for an ID and password.

Insurance Fraud

Insurance Fraud has a number of meanings depending upon each individual's position in the big picture; insured, claimant, insurer, producer or regulator. Fraud by the insured usually comes in two types, fraud in the application or fraudulent claims. This article will focus on misrepresentation or fraud in the application.

While New York Insurance Law codifies specific provisions regarding misrepresentations, the burden on insurers is nevertheless stringent.

In a recent New York case, the Appellate Division, Third Department, ruled that an insurer cannot involk the provisions of Insurance Law Section 3105 **to rescind** workers' compensation coverage, notwithstanding material misrepresentations in the application for coverage. The court cited public policy grounds in stating that the cancellation law notice requirements must be strictly enforced to prevent a denial of benefits to an innocent injured party. The result of this case "In the Matter of Jesus Cruz" puts workers' compensation policies in the league of unrescindable policies along with no fault coverage. While the court did not address the question, it would appear that the insurer could sue the named insured to recover, as its damages, the benefits paid.

Even in lines of coverage where the remedy of recession is available, the burden of proof imposed on insurers is substantial.

To paraphrase Section 3105, a representation is a statement of past or present fact made in applying for insurance to induce an insurer to provide coverage by the applicant or by someone with authority on behalf of the applicant. A false representation is not sufficient to involk 3105. The misrepresentation needs to material to the application. This means the insurer must demonstrate that it has acted upon such information

in the past in refusing to insure risks. Evidence on behalf of the insurer is often generated by underwriter testimony, underwriting manuals and the information obtained through insurance applications. A number of cases have turned upon whether the application questions are clear and unambiguous.

Courts are reluctant to deny an insured the benefit of an insurance contract purchased and will not do so if the insurance application questions are ambiguous.

The Hard Market

While much of the industry's trade press is reporting a softening in the P&C market, it has not hit the New York E&S marketplace yet.

ELANY's recorded volume through the first six months of 2005, once again set records in both the premium and transactions processed counts. \$1,790,000,000 and \$1,388,100,000 were the gross and net taxable premium totals through June 30, 2005, while the transaction count was 102,348.

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Claims Made Policies and the Excess Line Market

Most brokers are aware that excess line policies are exempt from Insurance Regulation 121 (11 NYCRR 73) regarding minimum requirements for claims made policies. Nevertheless, a recent case citing this exemption demonstrates an old legal adage, "bad facts make bad law."

The pertinent case is *The Segal Company vs. Certain Underwriters at Lloyd's*. Segal purchased both a primary and an excess professional liability policy from Lloyd's for the period April 15, 2000 to April 15, 2003. It appears the loss ratio for the account exceeded 2000%. The lower court ruling and the Appellate court appear to differ slightly in one respect which relates to the insured's demand for extended reporting (tail) coverage. The lower court suggested the insured sought this coverage when the broker indicated Lloyd's would offer no renewal terms. The Appellate court suggested the insured received renewal terms from Lloyd's which included a primary claim deductible fifteen times the expiring deductible and at fifteen times the expiring premium. The insured rejected the offer as not constituting renewal terms and demanded extended reporting coverage. Lloyd's rejected the demand for tail coverage asserting any offer of terms, no matter how different from the expiring terms, constituted a renewal offer alleviating it of any contractual duty to offer extended reporting coverage.

The Appellate court, relying on several exemptions in Regulation 121, reversed the trial court's ruling that the insured was entitled to purchase extended discovery coverage as a matter of public policy.

This case, no doubt, was a difficult one for the courts to adjudicate. First, the underwriters lost their shirt on the risk; and essentially, in order to avoid staying on the risk, offered outrageously different terms and conditions which the insured would clearly reject leaving the underwriters the ability to avoid providing extended discovery coverage. The insured, on the other hand, obtained substantial benefits under the policy but desired to purchase extended discovery coverage when it was apparent acceptable renewal terms would not be forthcoming.

Even though the policy made clear any offer of terms constituted renewal terms, that policy provision rendered the insureds right to extended discovery coverage illusory.

Since all contracts assume the duties of good faith and fair dealing, it appears allowing one party to render another's contract rights illusory, is fundamentally unfair.

Perhaps the courts should have looked to Section 3426 for guidance. While the cancellation and non-renewal notice provisions do not apply to excess line policies, applying the strict definition of renewal under New York Law to this excess line policy would have superceded a contract provision which defined renewal as anything the underwriters offered.

The holding, as it now stands, leads to an appearance that the excess line market may have outwitted the insured. This is not the collective reputation the industry desires.

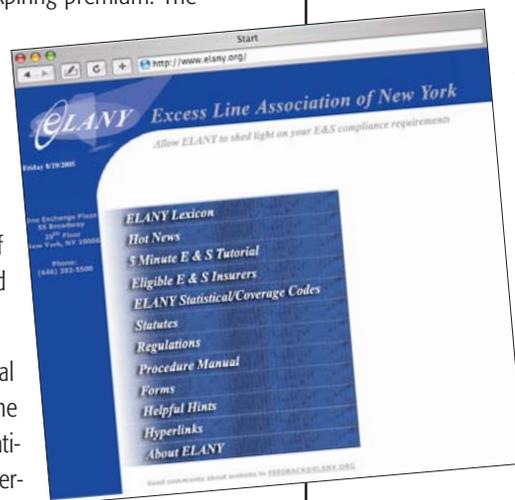
ABA Publishes Annotations to Surplus Lines Statutes Fourth Edition

If you are interested in a quality guide to the surplus line statutes state by state, the American Bar Association has the right publication for you. To order this guide call the ABA at 1-800-285-2221.

Uncollectable Excess Line Premiums

Excess line brokers ask ELANY whether they owe excess line tax on earned but uncollected excess line premium. The short, unfortunate answer is yes.

The law imposes the legal duty to pay excess line taxes on the excess line broker. While the excess line broker can legally charge the insured the tax under a total cost form pursuant to §2119 of the insurance law, it does not relieve the excess line broker as the party who is legally responsible to pay. Therefore, if you cannot collect the taxes owed (even on an audit additional premium) the tax is still due.



Website—Just Right

ELANY's website at www.elany.org puts a tremendous amount of user friendly information at your fingertips. Access the Hot News Section for recent bulletins and a calendar of events. See the Lexicon for pointed answers to your most important E&S questions.