Surplus Lines Basics – Part 2

Welcome to Part 2 of our educational series on Surplus Lines Basics! In Part 1, we focused on why the surplus lines market exists and the particular regulations that govern it. For Part 2, we'll discuss individual risk underwriting and how surplus lines risk selection varies from the standard market. We'll also talk about some supplemental applications and forms that are often seen with surplus lines policies. Lastly, we'll go a little deeper into the discussion of surplus lines affidavits and why we require them to bind.

If you are familiar with submitting risks to the surplus lines market, you may have noticed that the underwriters ask many questions and always want you to fill out additional applications. What is that all about? Because we see difficult and unique risks, we need to make sure we really understand the risk and its exposure before taking it on. An insurance underwriter is kind of like a gambler who is betting the company's money that a particular account will have few, and hopefully, no losses. If you were betting your own money on something, you would want to know as much as you could about it, right.

How do you get your surplus lines underwriter all of the additional information they need and still get your quote as quickly as you need it?

The best thing to do is to write a cover letter (include it in your email). It doesn't have to be too fancy, but include the information up front. Many of you are probably already doing this both with your admitted and non-admitted underwriters, but there may be more information required to underwrite a surplus lines risk. In your cover letter, include the current carrier and the reason you are looking to move it, or why you want to quote it in a new market. You may also want to include the desired price range, so the underwriter can quickly assess whether they can be competitive. Give an explanation as to why it is being placed in the surplus lines market, describe any unique exposures and explain why it is different from the average account.

Include a supplemental application if you have one. Many providers, including Berkley Aspire, will accept other carriers' supplements, as long as the needed underwriting information is there. If you are an appointed agent with Aspire, you can log into our Agent's Portal to access all of our supplemental applications.

Why do surplus lines companies need supplemental applications?

In case you are not familiar with the term, a supplemental application asks for class specific information that is not included on an ACORD form. This additional information helps underwriters determine if the risk fits within the underwriting guidelines. Supplemental applications are typically class specific and dig down deeper regarding the exposures that are unique to that class of business.

Why does every surplus lines market have different supplemental applications?

Each insurance provider has their own underwriting guidelines that includes risks they do like to see or do not like to see. The supplemental application asks the questions that the underwriter needs to know to qualify a risk. Sometimes, the answers to the questions might also open up more follow up questions that the underwriter will want to know. Particularly if the risk varies from others in the same class.

Appetite and Risk Selection

As we say in surplus lines underwriting, there are no "cookie cutter" risks. One type of roofing contractor may vary widely from another. Each one is considered on its individual risk characteristics, such as installation methods, the height of the structures they work on, the pitch of the roof and the materials they use.

Let's take a look at these two examples. Although both are roofing businesses, they present very different exposures.

Roofing Contractor A

- Primarily residential
- Asphalt or tile
- Up to 3 stories
- Pitched Roofs
- In business 1 year
- $1M in expected sales

Roofing Contractor B

- Primarily commercial
- Asphalt, form or metal
- Up to 12 stories
- Flat roofs
- In business 20 years
- $20M in expected sales

It is pretty obvious that Contractor B will have a higher premium, due to the amount of sales they have. However, which one do you think will have the higher base rate? Each one of these factors and their loss experience are taken into consideration when rating and pricing a roofing contractor's policy.

So, how do surplus lines providers manage to cover risks with high exposures?

We do it by careful utilization of coverage exclusions, limitations and manuscript forms. Surplus lines underwriters have the ability to customize coverage for each individual risk through an extensive forms library.

Here are some examples of some typical exclusions and limitations forms that are common to the market. All surplus lines companies use their own, similar versions of each of them:

Total Pollution Exclusion – This is a form that is intended to exclude coverage that is better covered elsewhere. If an insured has a pollution exposure, it is best they cover that with a stand-alone pollution policy that will offer the coverage they need for their unique exposures. A general liability policy is not intended to cover this kind of exposure.

Total Exclusion of Engineered Nano-particles – Nano-particles are currently used in some types of products, but are still a relatively new technology. This is a good example of an emerging risk that is still somewhat an unknown exposure that may present itself sometime in the future. Adding this exclusion gives underwriters the flexibility to write the GL for an account that may, at some point have this exposure. However, since it is a new technology, we don't know what the long term ramifications will be, so we exclude it.

Residential Construction Limitation – Many surplus lines providers have an appetite for residential general contractors and subs, but they are not interested in writing those that are

involved in residential tract building. This form limits coverage to a specific number of units in the development that the insured is working on during the policy period. This manages the carrier's exposure to large, class action, construction defects lawsuits that are prevalent in some states. You should note that this is a fillable form, so the underwriter can adjust the number of homes, depending on the states and the type of work done.

Surplus Lines Affidavits

A surplus lines affidavit is a confirmation that you (the retailer) have done the due diligence search to obtain coverage in the standard market, prior to placing coverage in the surplus lines market. If you are writing surplus lines business in any of these states, you must complete the affidavit. These states require that a copy of the affidavits is in the underwriting file, so we must have them to bind coverage. Make sure to note that surplus lines regulations are applied by the state in which the risk, or exposure is located.

These 25 States Require Surplus Lines Affidavits:

Alaska
California
Colorado
Connecticut
Florida
Illinois
Indiana
Kentucky

Massachusetts
Minnesota
Montana
Nevada
New Jersey
New Mexico
New York
North Dakota
Ohio

Oklahoma
Oregon
Pennsylvania
Rhode Island
Tennessee
Utah
West Virginia
Wyoming

To access regulations for particular states, there are resources available online, such as this one we found by Locke/Lord that has a state by state breakout of state regulations. It's a nice manual to have on hand, particularly if you place business for insureds have risks in multiple states.

https://surplusmanual.lockelord.com/

Stamping Offices & Reporting

Stamping offices are non-governmental offices that play a key role in the surplus lines industry. These offices, which exist in 15 states, help oversee transactions in order to prevent ineligible insurers from transacting business in a given state's surplus lines market. They are also responsible for collecting the surplus lines tax filings from the broker and add a stamping fee. These stamping fees help cover the costs of the surplus lines association. Surplus Lines Associations are responsible for consolidating the tax filings which are then reported and paid to the state department of insurance.

In most cases, your E&S insurance provider will handle the tax filings on your behalf.