



**THE SURPLUS LINE ASSOCIATION
OF CALIFORNIA**

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March 19, 2007

BULLETIN #1123

**RE: CLARIFICATION ON INDEPENDENT PROCUREMENT
AND COURTESY FILINGS**

The SLA General Counsel, James R. Woods of LeBoeuf, Lamb, Greene & MacRae LLP has written two memorandums to the Surplus Line Association of California. The first memorandum clarifies the requirements under the California Insurance Code concerning "independent procurement" of insurance from an unauthorized nonadmitted insurer. The second memorandum provides clarification regarding the propriety of so-called "courtesy filings".

Please be advised that SLA Bulletins are issued as a service to Members regarding surplus line issues the SLA considers significant. Views expressed in SLA Bulletins are solely those of the SLA. Nothing in this Bulletin may be construed as reflecting the view of the California Department of Insurance or its approval of anything contained herein.

Sincerely,

A handwritten signature in black ink that reads "Theodore M. Pierce". The signature is fluid and cursive.

Theodore M. Pierce,
Executive Director

LEBOEUF, LAMB, GREENE & MACRAE LLP

ONE EMBARCADERO CENTER
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March 8, 2007

TO: Surplus Line Association of California
FROM: James R. Woods
RE: **Independent Procurement (CIC § 1760)**

This memorandum clarifies the requirements under the California Insurance Code (“CIC”) concerning “independent procurement” of insurance from an unauthorized nonadmitted insurer involving the services of a surplus line broker acting as a “consultant.”

According to inquiries the SLA has received, it appears that certain insurance brokers located outside the United States have been advising that a surplus line broker may lawfully export a risk to an alien nonadmitted insurer that is not LESLI-approved by:

- characterizing the placement as a “independent procurement” under CIC § 1760,
- instructing the insured to pay directly the premium tax associated with the placement,
- characterizing the surplus line broker’s role as that of a “consultant” providing services to the offshore broker, and
- being compensated in the form of a “consulting fee” paid by the offshore broker equal in amount to the brokerage commission the “consultant” would receive if acting as a licensed surplus line broker for an authorized placement.

Any such advice would be incorrect under California law.

A. Permitted Surplus Line Placements

Placement of a risk with a nonadmitted insurer by a licensed surplus line broker is authorized under the CIC only in the following circumstances:

- Placement with an authorized nonadmitted insurer approved by the CDI and whose name appears on the current LESLI list in compliance with CIC §1763.
- Placement with an unauthorized nonadmitted insurer where “the use of multiple insurers is necessary to obtain coverage for 100% of the risk” and the placement otherwise satisfies the requirements of CIC §1765.1(k).

Surplus line brokers involved in placements for compensation with **unauthorized nonadmitted insurers**, unless the placement is expressly exempt under the CIC, expose themselves and the insurer with which the placement is made to the following potential risks:

For surplus line brokers –

- Disciplinary action under the CIC including license revocation
- Liability for surplus line tax applicable to the placement
- Liability for unpaid losses arising under the unlawful placement

For nonadmitted insurers –

- Enforcement action for transacting insurance in California in violation of CIC §35, including substantial fines and penalties.
- Permanent disqualification for LESLI approval and GAP placements

B. Independent Procurement

The concept of “independent procurement” appears in CIC § 1760, which provides:

- (a) Any person may negotiate and effect insurance to protect himself, herself, or itself against loss, damage, or liability with any nonadmitted insurer.
- (b) Every person that effects insurance governed by this Chapter shall pay the tax imposed by Part 7.5 (commencing with Section 13201) of Division 2 of the Revenue and Taxation Code.

Independent procurement pursuant to §1760 allows individuals, businesses, and other organizations to directly "transact" with nonadmitted insurers to obtain insurance for themselves, regardless of whether the nonadmitted insurer from whom they purchase insurance is LESLI-approved. Section 1760 does **not**, however, exempt a "consultant" or a licensed surplus line broker from any aspect of the surplus line laws.

C. Industrial Insured Exemption

Certain states exempt from their surplus line laws “transactions” involving placements with unauthorized nonadmitted insurers on behalf of an “industrial insured.” These “industrial insured exemptions” typically provide that the insurance may be obtained through the services of a “consultant” or “continuously retained consult.”

In effect, the “industrial insured exemption” in other states allows unauthorized nonadmitted insurers to “transact” with industrial insureds in that state.

In contrast, California's surplus line laws provide **no exemption** for a "consultant" who "transacts" on behalf of an "industrial insured" or otherwise. To lawfully "transact" with the nonadmitted market, a "consultant" must be licensed as a surplus line broker and the placement must comply with the surplus line laws.

D. Consultants

Clarification has been requested regarding whether a surplus line broker may lawfully act as a "consultant" in connection an "independent procurement" under CIC §1760.

No CDI Bulletin, Regulation or reported judicial decision in California has previously addressed this question. However, a surplus line broker wishing to act as a "consultant" in connection with a risk that the surplus line broker could not lawfully place with a nonadmitted insurer under the surplus line laws should consider the following:

- The term "transact" is defined by CIC §35:
"Transact" as applied to insurance includes any of the following:
 - (a) Solicitation.
 - (b) Negotiations preliminary to execution.
 - (c) Execution of a contract of insurance.
 - (d) Transaction of matters subsequent to execution of the contract and arising out of it.
- Surplus line brokers are specially licensed to "transact" with nonadmitted insurers, consistent with the requirements of the surplus line laws. *See, e.g.*, CDI Bulletin No. 96-4 (May 30, 1996), clarifying "Permissible Transactions by Surplus Line Brokers and Nonadmitted Insurers."
- There exists no exemption for a "consultant" under the surplus line laws, nor is there any other exemption under the CIC that allows a "consultant" to lawfully "transact."
- A "consultant" that "transacts" within the meaning of §35 must therefore be properly licensed under the CIC and otherwise comply with the requirements of the surplus line laws.

Accordingly, a surplus line broker should carefully consider whether to participate at all as a "consultant" in connection with an "independent procurement" involving insurance of a California risk by an unauthorized nonadmitted insurer. SLA Members would be well-advised to obtain advice of counsel before doing so.

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March 8, 2007

TO: Surplus Line Association of California
FROM: James R. Woods
RE: **Courtesy Filings**

Clarification has been requested regarding the propriety of so-called "courtesy filings." The term "courtesy filing" is generally understood to mean where a surplus line broker is asked to make the surplus line filings and associated surplus line tax filings on behalf of a broker or agent that does not hold a California resident or non-resident surplus line broker license.

California law does not recognize "courtesy filings." Nor does California law exempt so-called "courtesy filings," or licensees making them, from any requirements of the surplus line laws.

The term "courtesy filing" is a misnomer. It has no legal or regulatory significance. For the avoidance of doubt, the only type of surplus line filing recognized in California is one made by a licensed surplus line broker that complies in all respects with the surplus line laws.

By making the legally-required surplus line filings in connection with any placement, the surplus line licensee is responsible for full compliance with the surplus line laws whether the licensee originated the placement or not, regardless of whether the licensee is compensated for performing such functions. The licensee therefore must ensure that:

- A proper diligent search was conducted
- The insurer with which the placement is made is LESLI-approved or satisfies the requirements for a placement with an unauthorized nonadmitted insurer (*e.g.*, the "GAP exemption" under §1765.1(k))
- The risk is exportable
- The insured is provided with and signs the D1 Disclosure Notice and the D2 Disclosure Statement is affixed to the policy when issued.
- Surplus line tax is properly calculated and collected

- Surplus line tax is timely paid
- If applicable, multistate premium and surplus line tax is allocated properly
- Required documentation is completed accurately and timely filed
- The licensee complies with all other surplus line law requirements

Under the CIC, courtesy filings have long been viewed as the equivalent of a surplus line licensee "renting its license" to unlicensed persons. The historical rationale for certain courtesy filings was that an out-of-state broker could not be expected to obtain a California resident surplus line broker license for occasional transactions involving California risks.

California now offers a non-resident surplus line broker license that can be readily obtained by any surplus line broker licensed in another state. CIC §1639(e). The historical rationale for courtesy filings on behalf of non-resident surplus line brokers therefore no longer applies.

Any surplus line broker asked to make a courtesy filing should be mindful of the risks and obligations that the licensee assumes in doing so. The requesting resident or non-resident producer should be advised to obtain a California resident or non-resident surplus line license.