[INSIGHT] By Peter H. Bickford

Domestic Excess Line Carrier – An Oxymoron?

During the last legislative session, the Excess Line Association of New York proposed and the Senate passed legislation that would allow the establishment of domestic excess line carriers in New York. At first blush this sounds wrong. By their very nature excess and surplus line insurers are "non-admitted" foreign or alien companies that can only write New York risks through licensed excess line brokers, and only on risks that have either been rejected by "admitted" carriers or meet other specific requirements.

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But when you consider the subject, allowing domestic companies to write excess and surplus line business, it makes a lot of sense. What is the purpose of E&S business? Stated simply, it provides a means for domestic risks that cannot be insured in the tightly regulated admitted marketplace – particularly with regard to rate and form requirements -- to find appropriate coverage in an alternative, freer market. The justification for requiring these difficult risks to be written through "non-admitted" carriers is that domestic licensed companies must comply with all requirements of the law, including rate and form requirements, on all its business. Allowing non-admitted carriers to write this difficult business, with appropriate warnings to the customers that there is limited regulatory oversight and protection (i.e., no guaranty fund coverage) for the risks insured, somehow preserves the "integrity" of the admitted market.

One problem with this fiction is that many admitted carriers are fully equipped to write much of this business – including necessary capital, underwriting and claim infrastructure and expertise – but are restrained from doing so in an efficient and timely manner under this traditional framework, or without licensing a subsidiary in another state solely to write E&S in-state. The NY Free Zone offers admitted carriers a way to write some of these accounts through a Special Risk license, although without the full regulatory freedom provided to non-admitted E&S carriers. The proposed domestic excess line carrier legislation is a logical extension of the Free Zone concept that could lead to a greater expansion of available capacity for hard to place or large commercial risks while maintaining direct regulatory control over the financial stability and solvency of carriers.

The NY State Assembly did not definitively act on the proposed legislation by the end of session, but I understand that the proposal will be taken up again in the next legislative session. Also, the Department of Financial Services is expected to chime in on the proposal. Obviously, DFS support would be extremely helpful for the proposal to go forward successfully, and it is hoped that such support will be forthcoming.

There are a few significant issues, however, that should be addressed by the industry, DFS and legislators as they consider the proposal, including:

- Defining the extent to which domestic excess line carriers should be exempt from the insurance law provisions applicable to traditional admitted carriers;
- Establishing the actual status of these new carriers; e.g., should they be considered admitted carriers by other states (an essential element for 50 state access), non-admitted or some kind of hybrid;
- Defining the role of the excess line broker vis-à-vis this new class of carriers; and
- Assuring that this new class of insurer enhances rather than detracts from the role and integrity of traditional admitted carriers in the state.

(For anyone interested in more information on the issues regarding the proposed legislation, I recommend the report issued earlier this Summer by the Insurance Committee of the New York City Bar Association, which can be accessed under Committee Reports on the City Bar's web site, www.nycbar.com).

Done appropriately, permitting the use of domestic excess line insurers can be a boon to the insurance business in New York. Two other states, New Jersey and Illinois, have legislation on the books authorizing domestic excess line carriers. One company in New Jersey has been licensed under its statute (which has only been on the books for a year), but a baker's dozen companies have organized as domestic excess line insurers in E&S denizen Illinois, where the statute has been on the books since 1998. But the experiences of other states are largely irrelevant to good old 49 + 1 New York (referring, of course, to the nationwide perception of New York as a regulatory island unto itself). The concept of a domestic excess line carrier can have a far greater cachet to insular New York, and help it regain its status as an industry innovator and leader for unique market options such as the Free Zone or an insurance risk exchange.

Ah, yes! The mere mention of an insurance exchange evokes rolling eyes, primarily from those with real or imagined residual scars from the original 1980s exchange. However, for those insurance and financial industry leaders who actually understand the nature of the recent proposals to establish a modern, efficient syndicated capital marketplace, the concept of domestic excess line carriers makes perfect sense. Such entities would provide an additional option for specialized syndicates in a significantly controlled but flexible modern insurance risk exchange (IREX). Also, the ability to establish domestic excess line syndicates would address one of the persistent questions voiced by other state regulators about a new IREX: why should we let your syndicates write surplus lines in our state when they cannot do so in New York? (For example, consider Illinois: according to the Illinois Insurance Department's 2010 Annual Report, its 13 domestic surplus line carriers wrote close to $1 billion in net premium nationwide, but only a tenth of which was on Illinois risks).

The concept of a domestic excess line carrier is not as strange as it may seem, and it is a worthy subject for serious consideration by all groups interested in finding new market opportunities for the benefit of the insurance industry and its customers. [IA]