



## TEXAS DEPARTMENT OF INSURANCE

### Commissioner of Insurance (113-1C)

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Shawn Fabors  
President  
Texas Surplus Lines Association, Inc.  
Great Hills Corporate Center  
9020-I Capital of Texas Highway North, Suite 370  
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Dear Mr. Fabors:

I appreciate the opportunity to speak with you and other members of the board of Texas Surplus Lines Association (TSLA) earlier this week. I also want to thank you for notifying the Texas Department of Insurance (department) that the TSLA has finished distributing to its members the five-part series of articles on the "diligent effort" requirement of Insurance Code § 981.004(a). We subsequently obtained a copy of the articles through Mike MacCrory, Chairman of TSLA's Regulatory Liaison Committee. We appreciate TSLA's effort to educate its members on the diligent effort requirement. We found the articles raise many good points including that the diligent effort must be appropriately performed and documented, and the benefits of adopting management procedures to govern these functions. Reminding your members of statutory requirements assists the department with its legislative mandate to implement the Texas Insurance Code.

At this time, the department has not adopted specific rules relating to the diligent effort requirement of Insurance Code § 981.004(a). Staff is working on new rules for surplus lines, however, the current draft does not change the department's current approach to diligent effort. Prior to publication, the department explained to the series' author that it could not contribute to the series of articles because doing so could have opened the agency to charges of ad hoc rulemaking.

In the spirit of ensuring compliance, however, the department would like to provide some additional information to supplement the TSLA efforts, starting with the overarching purpose of surplus lines regulation in Texas, which is contained in Insurance Code § 981.001. It states:

- (a) An insurance transaction that is entered into by a resident of this state with an eligible surplus lines insurer through a surplus lines agent because of difficulty in obtaining coverage from an authorized insurer is a matter of public interest.
- (b) The transaction of surplus lines insurance is a subject of concern and it is necessary to provide for the regulation, taxation, supervision, and control of these transactions and the practices and matters related to these transactions by:
  - (1) requiring appropriate standards and reports concerning the placement of surplus lines insurance;
  - (2) imposing requirements necessary to make regulation and control of surplus lines insurance reasonably complete and effective;
  - (3) providing orderly access to eligible surplus lines insurers;
  - (4) ensuring the maintenance of fair and honest markets;
  - (5) protecting the revenues of this state; and
  - (6) protecting authorized insurers, which under the laws of this state must meet strict standards

relating to the regulation and taxation of the business of insurance, from unfair competition by unauthorized insurers.

- (c) To regulate and tax surplus lines insurance placed in accordance with this chapter within the meaning and intent of 15 U.S.C. Section 1011 and 15 U.S.C. Chapter 108, this chapter provides an orderly method for each person whose home state is this state for a particular transaction to effect insurance with eligible surplus lines insurers through qualified, licensed, and supervised surplus lines agents in this state, if coverage is not available from authorized and regulated insurers engaged in business in this state, under reasonable and practical safeguards.

Again, the department appreciates TSLA's efforts to educate its members about this important issue, and the series of articles contain many helpful observations. We wanted to remind TSLA's members of Insurance Code § 981.001 because the department perceived certain instances where the recent articles arguably seemed to suggest that broad competition with the licensed, regulated insurers may be lawful, which may inadvertently lead to non-compliance. The department wishes to urge caution and respectfully points out a few examples from the articles that may result in compliance issues, such as the following:

- While the "diligent effort" requirement of Insurance Code § 981.004(a)(1) was discussed at length, subsection (b) was not mentioned. Section 981.004 provides guidance on when a surplus lines policy may be issued. Subsection (a)(1) provides that a surplus lines is appropriate when: "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." Subsection (b), however, states that "[a]n eligible surplus lines insurer may provide surplus lines insurance only in the amount that exceeds the amount of insurance obtainable from authorized insurers." TSLA may want to remind its members of this important requirement.
- The third article concludes with the suggestion that the "diligent effort" requirement is limited in a manner that we do not find in Texas law. As an example, the conclusion implies that an agent may place a policy in the surplus lines market simply because the agent is not appointed to sell that product, including instances where ample capacity exists in the admitted market.
- The fourth article could mislead your members, as it gives an example that considers the cost of a homeowner's policy as a part of the consideration when determining compliance. Rates for homeowner's insurance vary greatly based on the specifics of the property and the coverage. If an admitted policy can be obtained, the cost of the surplus lines policy is moot. As a point of reference, last year 119,854 Texas homeowner's policies were issued in the surplus lines market.

On the other hand, we appreciate that this same article states that agents should exercise special caution when considering whether to place the type of insurance that affects the most Texans - homeowner's and auto - in the unregulated surplus lines market. It goes without saying that the lack of guaranty fund coverage is one of the more significant concerns.

The department looks forward to working with you in the future to continue the dialogue of how the department and industry can implement the diligent effort requirements of § 981.004 in a manner that is both workable for surplus lines agents and true to the intent of the law. Finally, we ask that you share this letter with TSLA's members.

Sincerely,



David C. Mattax  
Commissioner of Insurance