

A PRIMER ON THE SURPLUS LINES “DILIGENT EFFORT” DUTY

The Last in a Series of Articles

The “Diligent Effort” Duty: A Critical Surplus Lines Market Gatekeeper

In late 2015, TSLA published a series of *TSLA Member Newsflash* articles discussing various issues relating to the “diligent effort” legal requirement that applies to every surplus lines insurance transaction except the new “Exempt Commercial Purchaser” class of transactions. The purpose of the series was to remind TSLA members and their agency staffs about the importance of the “diligent effort” requirement and provide some helpful background information and suggestions that might make compliance with it a bit easier.

TSLA members are apparently already doing a great job in complying with the law. During the 2015 Regular Session of the Texas Legislature, serious consideration was given to revising the requirement, either by a change in the current Administrative Rules governing it or in the current Insurance Code provision itself. During those discussions, the TDI informed the author of TSLA’s proposed “diligent effort” reform legislation, Representative Morgan Meyer of Dallas, that it had records of receiving a total of only six complaints alleging violations of the “diligent effort” requirement over the past five years. That’s *six* complaints out of roughly 4.3 **Million** Stamping Office filings over the same five-year period, including approximately 925,000 filings in calendar year 2014 alone.

In response to a suggestion that the “diligent effort” requirement be further buttressed by legislation re-imposing the pre-1990’s requirement of an “affidavit” of compliance, TSLA responded that one of its most sophisticated members had estimated that a new requirement of a single-page affidavit would add \$15 to \$20 to the transactional cost of each surplus lines policy or other evidence of coverage issued. That would mean that such a change in the law would have cost Texas surplus lines insurance consumers at least an additional \$13.875 Million for 2014’s 925,000 filings, or \$11.6 million per complaint at the five-year average complaint rate of 1.2 complaints per year.

Nevertheless, TDI remains concerned about the possibility of surplus lines policies being issued even when the coverage sought by the consumer is available from admitted carriers, and *most especially when the transactions involve personal lines insurance such as homeowners or personal auto coverage*. The same discussions also resulted in a commitment by TSLA to initiate an

ongoing education program for its members about the “diligent effort” duty. The *TSLA Newflash* series is the first step in the fulfillment of that commitment.

The following is a summary of the highlights and general “rule-of-thumb” guidelines offered by the series to help the surplus lines agent comply with the “diligent effort” requirement:

- ***Section 981.004(a), Texas Insurance Code, states that surplus lines insurance can only be procured from an eligible surplus lines insurer if:***
"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." [Emphasis added]
- *“If the coverage sought is obtainable from an admitted carrier, a surplus lines policy for that coverage cannot be issued.”*
- *“For now, the wisest approach is for surplus lines agents to conduct their business on the assumption that the ultimate responsibility for satisfying the “diligent effort” duty belongs to them.”*
- *“Be aware of the duty and consistent in making the effort in a manner appropriate to the circumstances of the transaction; and systematically communicate with the retail agent regarding the marketing efforts undertaken.”*
- *“Develop and follow clear, written management procedures governing both the “not obtainable” determination and its documentation which are appropriate to the particular business needs and practices of the agency.”*
- *“Develop a collaborative relationship with the retail agents with whom the agency does business that features an on-going communications component of its marketing program that promotes a clear understanding of the responsibilities and expectations of each agent.”*

Some suggested practical techniques for achieving “diligent effort” compliance are also available on the TSLA website in the Members Only section.

The members of TSLA and their agencies have done a terrific job in the past in complying with the “diligent effort” duty of Section 981.004(a). For the future, just keep up the good work.

The contents of this article are intended for the general information of TSLA members and their agency staff members. It is not intended to constitute legal advice. Members are urged to consult their own attorney for guidance and advice on matters relating to this important subject.