

**State of California  
Department of Insurance  
45 Fremont Street  
San Francisco, California 94105**

**Bulletin 96-4**

**Affiliation with nonadmitted insurers; permissible transactions by surplus line brokers and nonadmitted insurers**

May 30, 1996

The purpose of this bulletin is to provide information to licensed California surplus line brokers concerning the Commissioner's views of certain surplus line market practices with respect to transactions performed in this state by licensed surplus line brokers, particularly those affiliated with a nonadmitted insurer or part of a corporate family that includes a nonadmitted insurer. The term nonadmitted insurer as used in this bulletin is limited to nonadmitted insurers eligible for placements by California surplus line brokers under section 1765.1 of the Insurance Code.<sup>1</sup>

The Insurance Commissioner appointed a Task Force composed of both California Department of Insurance ("CDI") staff members and insurance industry representatives in August 1995 to review the CDI's administration of the applicable statutes and relevant court cases and its impact on current market practices in this segment of the industry with respect to surplus line brokers' transactions and affiliations with nonadmitted insurers. Having carefully considered the Task Force's conclusions, the Commissioner determined that it would be beneficial to inform the industry of the CDI's general policy in administering the statutes and regulations governing surplus line transactions.

1. Regulatory overview

The Insurance Code authorizes California surplus line brokers to conduct an "insurance brokerage business" in this state. § 1765(b). Insurance brokers are distinguished from insurance agents by the fact that brokers act, primarily, on behalf of the insured and not on behalf of the insurer. See CIC § 33. The reverse is true of insurance agents. It is also well established, however, that brokers have a "dual capacity," performing activities as agent of the insurer for certain purposes and as agent of the insured for others. See, e.g., § 1732, Maloney v. Rhode Island Ins. Co., 115 Cal. App. 2d 238, 251 P. 2d 1027 (1953). This implicit authorization for a surplus line broker to perform various agency activities on behalf of a nonadmitted insurer does not authorize a surplus line broker to perform core management functions for a nonadmitted insurer, or a cumulation of core insurance company functions, so that the result is tantamount to establishing and operating a managing general agency or branch office of a nonadmitted insurance company in this state without a certificate of authority. See Mor-Ben Insurance Markets Corporation v. Department of Insurance, 179 Cal. App. 3d 1233, 225 Cal. Rptr. 281 (1986); § 700, 703, 1776: cf. § 810.

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<sup>1</sup> All statutory references are to the California Insurance Code unless otherwise indicated.

2. May a surplus line broker be affiliated with a nonadmitted insurer?

No statute or regulation prohibits a licensed surplus line broker from being affiliated with a nonadmitted insurer, directly or indirectly. However, the Commissioner believes that there is a strong potential for conflict of interest when an officer or salaried employee of a nonadmitted insurer is affiliated with a surplus line broker.

To remove such potential conflicts, the Commissioner will consider when reviewing such affiliate relationships whether they comport with the substance of section 1649. Section 1649 prohibits an officer or salaried employee of an admitted insurer from acting as a fire and casualty insurance broker. While section 1649 does not on its face apply to nonadmitted carriers or their officers or employees, the Commissioner considers this section as providing guidance as to how this type of potential conflict is to be handled in the nonadmitted context. Accordingly, the Commissioner objects to a California surplus line broker having officers and salaried employees acting as brokers who are also officers or salaried employees of its affiliated nonadmitted insurer. However, the Commissioner has no objection to overlapping officers or salaried employees of a nonadmitted insurer and its affiliated surplus line broker who serve in administrative capacities, such as corporate counsel or accounting positions, for both entities and are not transactors under the surplus line license.

3. What transactions may be performed in this state by a surplus line broker that is affiliated with a nonadmitted insurer?

Transactions that a licensed California surplus line broker is permitted to perform in this state are the same regardless of whether or not the surplus line broker is affiliated with the nonadmitted insurer with which it does business. The scope of such permissible transactions is enumerated below.

A. Solicitation

- (1) California surplus line brokers may advertise and solicit using print, electronic media and direct mail advertisements. These advertisements may describe the products available through the surplus line broker, so long as the nonadmitted insurer's name is not used in connection with a specific product. This would not prohibit a California surplus line broker from identifying which nonadmitted insurers have given it placing authority if the nonadmitted insurer's name is not used in a manner that connects it with any specific product. However, the surplus line broker must provide the name of the nonadmitted insurer if it is requested by a prospective insured or his, her or its representative.

Section 703 makes it a misdemeanor for any person other than a surplus line broker to advertise in California on behalf of a nonadmitted insurer. As interpreted by the Mor-Ben court, this provision exempts surplus line brokers from criminal penalties but does not affirmatively authorize

surplus line brokers to engage in advertising on behalf of a nonadmitted insurer or any of the other acts enumerated in that section. It has, however, long been the CDI's position that surplus line brokers may advertise and solicit on their own behalf and in their own name, but not in the name of the nonadmitted insurer.

- (2) Nonadmitted insurers may not mail advertisements or solicitation materials to insureds or prospective insureds located in California. See People v. United National Life Insurance Company, 66 Cal.2d 577, 58 Cal.Rptr. 599, 427 P.2d 199 (1967); § 703(b).
- (3) Nonadmitted insurers may not advertise in publications specifically targeted at the California market. § 703(b).
- (4) Nonadmitted insurers may advertise in national publications that would reasonably be expected to reach California insureds or prospective insureds, so long as the nonadmitted insurer includes a disclaimer such as "not licensed in California," "this product may not be available in all states," "unavailable except through a licensed surplus line broker," or similar language. However, if a nonadmitted insurer's product is mentioned in such advertising, the nonadmitted insurer will be deemed to have solicited in this state unlawfully if it sells the product to a California resident even though such disclaimer appeared in the advertisement.
- (5) Except as permitted in subsection 3.A.(4) above, advertising of a Nonadmitted insurer or its products in California by anyone other than a surplus line broker is not permitted. § 703(b).

B. Acceptance/Declination of Risks; Binding Authority; Risk Quotation

- (1) The ultimate decision as to rate setting and establishing underwriting guidelines must be performed by the nonadmitted insurer outside the State of California. However, surplus line brokers may be delegated prior written authority to bind coverage (i.e. "binding authority") on behalf of a nonadmitted insurer in accordance with section 1764.2(a). Binding authority may not be delegated to any person in this state other than a licensed California surplus line broker.
- (2) Although the ultimate authority to set rates and establish underwriting guidelines may not be delegated, the prior written authority delegated to the surplus line broker may grant the surplus line broker authority to apply an appropriate rate and quote based on the rating or underwriting guidelines established outside the state by a nonadmitted insurer.

C. Surplus Line Brokers' Certificates Evidencing the Placement of Insurance; Policies; Preparation, Execution, and Issuance

- (1) With respect to surplus line broker's certificates evidencing the placement of insurance, surplus line brokers are permitted to print, maintain, execute and issue in this state "certificates in their own name and not in the name of the nonadmitted insurer," evidencing the placement of insurance. Section 1764 et seq. A specimen of such certificate that the Insurance Commissioner considers to comply with this requirement is attached. Surplus line brokers' certificates, so long as they comply with 1764 and contain all the provisions of the insurer's policy as required by section 381<sup>2</sup>, are contracts of insurance enforceable against the insurer to the same extent as the insurer's own policy.

Please note that the term "certificate" is used to describe different kinds of evidence of insurance, not all of which qualify as "surplus line brokers' certificates" under section 1764 et seq. For example, the standard "ACORD<sup>3</sup> certificate" is not designed to serve as a surplus line broker's certificate under section 1764 et seq. and should not be used for that purpose (although a surplus line broker may issue an ACORD certificate for its intended purpose, i.e., at the request of an insured under a properly issued and evidenced policy to demonstrate to a third party that the insured in fact possesses insurance).

- (2) With respect to nonadmitted insurers' policies, unless and until the Legislature authorizes otherwise, surplus line brokers are not authorized by current statutes to execute, countersign or otherwise issue, in this state, an insurance policy in the name of a nonadmitted insurer. In addition, surplus line brokers may not, in this state, print, maintain, assemble or compile policy forms on behalf of a nonadmitted insurer in this state.

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<sup>2</sup> Section 381 provides: "A policy shall specify:

- (a) The parties between whom the contract is made.
- (b) The property or life insured.
- (c) The interest of the insured in property insured, if he is not the absolute owner thereof.
- (d) The risks insured against.
- (e) The period during which the insurance is to continue.
- (f) Either:
  - (1) A statement of the premium, or
  - (2) If the insurance is of a character where the exact premium is only determinable upon the termination of the contract, a statement of the basis and rates upon which the final premium is to be determined and paid."

With respect to subdivision (d) of Section 381, all terms, conditions, exclusions, riders, and endorsements should appear in, or attached to, a surplus line broker's certificate evidencing the placement of insurance if issued pursuant to prior written authority from the nonadmitted insurer.

<sup>3</sup> ACORD is a trade name for "Agency Company Organization Research Development," an organization which develops and markets insurance forms.

If the nonadmitted insurer has given the California surplus line broker prior written authority to issue certificates in the name of the surplus line broker as evidence of insurance in lieu of a policy, the certificate will be an effective and enforceable contract of insurance.

A surplus line broker, on behalf of the insured, may prepare appropriate documents that constitute a formal, bona fide offer to the insurer containing proposed terms and conditions of coverage, provided such documents appear on their face to be an offer. The insurer may then accept or decline the offer; however, any acceptance of the offer by the insurer must be bona fide. Surplus line brokers may print, maintain, assemble or construct such an express offer of coverage for presentation to a nonadmitted insurer.

After acceptance of the offer (which must occur outside the state), the insurer will deliver the policy to the surplus line broker for delivery to the insured (or other intermediate party).

D. Claims

- (1) A surplus line broker may be given prior written authority to pay undisputed claims on behalf of a nonadmitted insurer. A surplus line broker, however, may not decline or negotiate claims or provide any claims management. All non-paid claims must be referred to the nonadmitted insurer or to a licensed adjuster designated by the nonadmitted insurer.
- (2) Claims adjustment functions may be performed in this state on behalf of a nonadmitted insurer by a properly licensed insurance adjuster, regardless of whether or not the licensed adjuster is affiliated with the nonadmitted insurer. A surplus line broker may be licensed as an adjuster, subject to the provisions of section 816, which provides in substance that a person who has been given any discretion in the settlement of claims may not be compensated in any way that is contingent on the amount of such claims settlements, unless:
  - (a) the person's discretionary settlement authority is no more than \$500 per claim,
  - (b) the person is compensated wholly or partly by contingent commission based on underwriting results, so long as the insurer is not guaranteed a return which may exceed actual underwriting profit,
  - (c) the claims settlement authority relates exclusively to reinsurance contracts between insurers, or

(d) the person is compensated according to a schedule of charges that increases consistently in reasonable brackets as the size of claim increases. § 816(a) - (d).

E. Management Functions

(1) Performance of certain key management functions in this state by or on behalf of a nonadmitted insurance company is deemed to be the transaction of insurance as contemplated by sections 35 and 700 of the Insurance Code, and accordingly, requires a certificate of authority. The Commissioner has concluded that the following are insurance company management functions that may not be performed in California on behalf of the nonadmitted insurer by a surplus line broker or other representative of the nonadmitted insurer, whether or not affiliated with the nonadmitted insurer, without a certificate of authority:

(a) Arranging or placing treaty reinsurance.

(However, this does not prohibit a surplus line broker from arranging or placing, on behalf of an insurer, facultative reinsurance, which is procured by the surplus line broker in order to obtain capacity for the coverage and limits requested by the insured. Surplus line brokers should also be aware that in arranging or placing such reinsurance they are subject to the Reinsurance Intermediary Act, Ins. Code §§ 1781.1 - 1781.13.<sup>4</sup>)

(b) Managing insurance company investments.

(However, this does not prohibit a surplus line broker from investing premiums that are held in a fiduciary capacity in accordance with sections 1734 or 1734.5.)

(c) Managing payroll and personnel matters, including making personnel decisions, concerning employees or officers of a nonadmitted insurer.

(d) Managing claims.

(However, this does not prohibit a surplus line broker from receiving notices of claims and paying [but not denying or

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<sup>4</sup> Under the Reinsurance Intermediary Act, a "reinsurance intermediary-broker" (i.e., a person or corporation who solicits, negotiates or places reinsurance cessions or retrocessions but has no power to bind the ceding insurer, § 1781.2(g)), must be a licensed producer in California, § 1781.3(a)(1), must ensure that he or she has written authorization from the ceding insurer that conforms to section 1781.4 and must maintain specified records for at least ten years after expiration of each reinsurance contract transacted, § 1781.5. Persons who act as reinsurance intermediary-managers (defined in § 1781.2(h)) are subject to more extensive requirements.

negotiating] the claims or referring them to the nonadmitted insurer outside this state or a California licensed adjuster designated by the nonadmitted insurer.)

F. Electronic Transactions

The Commissioner is cognizant of the great strides the insurance industry is making to utilize new electronic capabilities in improving the efficiency and competitiveness of its methods of doing business. The consumers will be among the ultimate beneficiaries of these technological advancements.

While new types of electronic equipment, networks and means of communication are increasing the speed and efficiency-of transactions and permitting greater automation of processes formerly handled in person, these improvements have not affected the fundamental nature of insurance transactions, which consists of an insured seeking to buy, and an insurer to sell, policies, with various intermediaries representing one, the other or both of those parties in bringing about the transaction. An insurer, or insurance producer representing an insurer, who has an Internet "web site" is doing fundamentally the same thing as it did when advertising or offering insurance through a magazine ad and including a pre-stamped, self-addressed return mailer for interested insureds.

Thus, in light of the legal principles governing solicitation by nonadmitted insurers described in section 3.A. above, a nonadmitted insurer whose web site would reasonably be expected to reach, or is purposefully directed at, California insureds or prospective insureds must include a disclaimer regarding its unlicensed status in California. Failure to include such a disclaimer may render unlawful whatever California business is subsequently written for insureds who were solicited through the web site.

Similarly, a nonadmitted insurer whose web site would reasonably be expected to reach, or is purposefully directed at, California insureds or prospective insureds, would be in violation of California law if the insurer's web site enables a California resident inside California to obtain an executed policy without it being procured by and through a licensed California surplus line broker. Whether a nonadmitted insurer mails, faxes or transmits over the Internet its executed policy to a person located in California without delivering it through a licensed surplus line broker, the transaction has the same substantive effect and in each instance is equally subject to regulatory action by the CDI.

Unless and until the Legislature authorizes otherwise, any surplus line transaction conducted via electronic media must be performed through a licensed California surplus line broker, rather than directly between an insured and a nonadmitted insurer. Furthermore, the surplus line broker must not simply be an electronic connection between the nonadmitted insurer and the applicant or insured. One way to demonstrate the absence of a mere electronic connection

would be to ensure that the insured or the insured's representative can communicate with an individual surplus line licensee or named transactor of an organizational surplus line licensee at any point in the transaction.

Surplus line brokers may communicate with the personnel or computers of nonadmitted insurers through any form of electronic media for any and all aspects of an insurance transaction. This includes preparing an offer containing the form of a policy that the insurer is being requested to execute by means of an interactive link with the nonadmitted insurer. However, surplus line brokers must comport with the statutory requirement (Ins. Code section 35) that policy issuance by the nonadmitted insurer or its representative occur outside of California. One example of an acceptable electronic transaction would involve all of the following steps:

Step 1 -- A California surplus line broker, on his or her computer terminal in California, contacts a nonadmitted insurer's computer. The nonadmitted insurer's computer must be located outside of California.

Step 2 -- On his or her computer terminal, the surplus line broker calls up an input screen from the nonadmitted insurer's computer or server located outside this state (or from the nonadmitted insurer's web site located on the server of an independent Server Provider<sup>5</sup>) which contains a program or template of the insurer's underwriting and rating guidelines. Those guidelines must have been established by the insurer outside California.

Step 3 -- The surplus line broker inputs the data about the applicant required for the insurer's computer to perform underwriting and rating of the applicant.

Step 4 -- Assuming the nonadmitted insurer's program approves binding on specified terms and at a specified rate, the computer may automatically transmit a policy, bearing electronic facsimile signatures. The policy may be printed in the surplus line broker's California office and the surplus line broker may deliver the policy to the insured or the insured's representative.

All of the foregoing steps may be performed automatically by the nonadmitted insurer's computer, so long as that computer or server is located outside California (or from the nonadmitted insurer's web site located on the server of an independent Server Provider).

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<sup>5</sup> As used in this bulletin, "Server Provider" means a person or entity, other than an insurance agent, broker, surplus line broker or insurance company, that is in the business of operating computer hardware and software facilities the purpose of which is to receive and fulfill requests by users of the Internet for data stored on or otherwise accessible through such facilities.

Questions concerning this bulletin should be directed to:

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Telephone (415) 904-5866

/s/ Chuck Quackenbush  
Commissioner of Insurance

**CERTIFICATE**  
of [NAME OF SURPLUS LINE BROKER]  
Evidencing Placement of Insurance  
Pursuant to California Insurance Code Section 1764

\_\_\_\_\_ ("Surplus Line Broker"), whose signature appears at the end of the Certificate Declarations on page 2, hereby certifies that insurance as described herein has been effected with the insurer or insurers listed in Certificate Declaration 4 ("Insurer") in accordance with the limited authorization granted to Surplus Line Broker by Insurer.

**NOTICE:**

1. THE INSURANCE POLICY THAT YOU HAVE PURCHASED IS BEING ISSUED BY AN INSURER THAT IS NOT LICENSED BY THE STATE OF CALIFORNIA. THESE INSURERS ARE CALLED "NONADMITTED" OR "SURPLUS LINES" INSURERS.

2. THE INSURER IS NOT SUBJECT TO THE FINANCIAL SOLVENCY REGULATION AND ENFORCEMENT WHICH APPLIES TO CALIFORNIA LICENSED COMPANIES.

3. THE INSURER DOES NOT PARTICIPATE IN ANY OF THE INSURANCE GUARANTEE FUNDS CREATED BY CALIFORNIA LAW. THEREFORE, THESE FUNDS WILL NOT PAY YOUR CLAIMS OR PROTECT YOUR ASSETS IF THE INSURER BECOMES INSOLVENT AND IS UNABLE TO MAKE PAYMENTS AS PROMISED.

4. FOR ADDITIONAL INFORMATION ABOUT THE INSURER YOU SHOULD ASK QUESTIONS OF YOUR INSURANCE AGENT, BROKER, OR "SURPLUS LINES" BROKER OR YOU MAY CONTACT THE CALIFORNIA DEPARTMENT OF INSURANCE[, AT THE FOLLOWING TOLL-FREE TELEPHONE NUMBER: 800-927 4357].

**CERTIFICATE DECLARATIONS**

- 1. Insured's Name:  
Address:  
Interest of Insured: (Only complete if Insured is not the absolute owner of the property insured.)
  
- 2. Effective Dates (Both days at 12:01 a.m. standard time at location of risk.)  
  
From:  
To:
  
- 3. Premium:  
State Tax:  
Stamping Fee:  
Other Fees:  
Total:
  
- 4. In consideration of the premium specified in Certificate Declaration 3 above, the following insurer or insurers has/have agreed to be bound as described herein. (If more than one insurer, all insurers and their respective percentages of the risk must be listed):  

<u>Name</u>	<u>Percentage</u>
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- 5. Coverage:  
  
(Must specify the property or life insured and risks insured against. Specimens of the intended policy forms and endorsements should be attached and incorporated herein by reference.)
  
- 6. Special conditions or endorsements:
  
- 7. In the event of a claim under the insurance described in this Certificate, please notify Surplus Line Broker or the following person:
  
- 8. Name and address of Insurer's agent for service of process in California:

Date: \_\_\_\_\_

\_\_\_\_\_  
Signature of Surplus Line Broker  
Typed Name:  
Organization Name (if applicable)

## CERTIFICATE PROVISIONS

1. Evidence of Insurance. This Certificate is evidence of the placement of the insurance described in the Certificate Declarations in accordance with Section 1764 of the California Insurance Code.
2. Signature Required. This Certificate shall not be valid unless signed by the Surplus Line Broker at the end of the Certificate Declarations.
3. Surplus Line Broker Not Insurer. The Surplus Line Broker is not an Insurer of the insurance described herein. The Insurers are only those insurers listed in Certificate Declaration 4.
4. Service of Suit Clause. In the event of the failure of Insurers to pay to any insured or beneficiary any amount claimed to be due under the insurance described herein, Insurers have agreed that the firm or person named in Certificate Declaration 8, or the Commissioner, Superintendent, or Director of Insurance or other officer, or his or her successor or successors in office, pursuant to the procedures set forth in section 1610 through 1620 of the California Insurance Code or equivalent provisions of the laws of any state of the United States, is its true and lawful agent for service of process in any action, suit or proceeding arising under the contract evidenced by this Certificate. If served on an officer as specified above, that officer is authorized to mail such process or a true copy thereof to the firm or person named in Certificate Declaration 8. After having been properly served in the manner described above, Insurers have agreed they will submit to the jurisdiction of a court of competent jurisdiction within California. However, nothing in this provision constitutes a waiver of Insurers' rights to remove an action to a United States District Court, or to seek a transfer of a case to another Court as permitted by the laws of the United States or of any State in the United States. Insurers have further agreed, in the event of such suit, to abide by the final decision of such Court or of any Appellate Court in the event of an appeal.
5. Attached Conditions Incorporated. The insurance described in this Certificate is subject to all the provisions, terms, conditions and warranties set forth herein, or attached or endorsed to this Certificate, all of which are to be considered incorporated herein as further descriptive of the insurance the placement of which is evidenced by this Certificate.