2. (2 points)

   a. (0.5 point)

   Describe a surplus lines insurance transaction.

   b. (1 point)

   Identify two types of insurance regulation from which surplus lines are exempt, and briefly describe a possible benefit to policyholders of each exemption.

   c. (0.5 point)

   Briefly describe two ways in which the surplus lines market is regulated.

CONTINUED ON NEXT PAGE

apply to the use of price optimization in a rate filing.

QUESTION: SPRING 2018 EXAM 6U, QUESTION 2	
TOTAL POINT VALUE: 2	LEARNING OBJECTIVE: A3
SAMPLE ANSWERS	
Part a: 0.5 point	
• A surplus lines transaction is a transaction in which a specially licensed surplus lines broker places insurance with and unauthorized/non-admitted insurer. • A surplus lines insurance transaction is one that is conducted in the non-admitted market after an insured has proven that they cannot obtain the insurance coverage in the admitted market. • Surplus lines transaction is in the non-admitted market for highly unique risks that have high limits or unique underwriting characteristics that can't be insured in the admitted market. • Insureds cannot get coverage in admitted market and are denied through "diligent search" due to high limits, difficult underwriting and high individualized risks. Then agents with special license place the policy with non-admitted market surplus line insurer. • Insurance is placed through a surplus lines broker with an insurer not authorized in state.	
Part b: 1 point	
• Do not have to file rates: This benefits policyholder since it increases availability by allowing insurers to charge an adequate premium; otherwise they would have to decline the policy like insurers in the admitted market • It is not subject to rate regulation; this benefit customers as insurer may offer the insurance at cheaper price, given it saves on compliance cost • Do not have to file coverage forms: This benefits the policyholders since it allows insurers to be more flexible; insurers can draft coverage to suit the specific needs of the insured who likely has unique risks • Not eligible for guaranty funds, it has an incentive to be financially strong since guaranty funds are not available, therefore protecting policyholders • Guarantee Funds: Surplus Lines are exempt from guarantee funds so the costs of the funds are not passed down to policyholders • Involuntary markets/assigned risk plans – Insurers do not have to take on any bad surplus line risks, so no subsidizing which is good for the policy holder • It doesn't need to be licensed in the state – benefit is that policyholders can have more options from these non-admitted insurers	
Part c: 0.5 point	
• There must be a "diligent search" to show that the product is unavailable in traditional insurance market • Agents must be responsible for the assessment of transaction • Still has to adhere to solvency requirements	

- Producers are specially licensed to sell surplus lines insurance
- Insurers must meet the minimum capital requirements to be able to sell surplus lines
- Licensure-surplus lines carriers must be licensed to write surplus lines
- Still required to file financial statements, which regulators can review
- Surplus lines carriers are still subject to the Sherman Act when it comes to boycott, coercion and intimidation (these acts are illegal)
- Surplus insurers must file annual statements
- Business can only be placed with insurers that meet specific managerial and financial requirements
- Surplus lines may still be subject to a market conduct exam. They still need to treat policyholders and claimants with respect and honesty with the way they do business
- Subject to RBC regulatory action levels
- Still need to meet high financial rating in order to sell surplus lines
- It can be regulated by the home state DOI of the insurer
- If a surplus lines insurer were to be considered a SIFI, they would be regulated by the FIO

EXAMINER'S REPORT

Candidates were expected to know concepts surrounding the surplus lines market, what constitutes a surplus lines transaction and the details around its regulation.

Part a

Candidates were expected to know what elements are needed to be present in order to have a surplus lines transaction

The main points expected to be conveyed were that the insured was rejected by the admitted market, utilized a specially licensed broker to place its business, and ultimately placed the business with a non-admitted insurer.

Common mistakes included:

- Not mentioning that insurance was placed with unauthorized/non-admitted insurer
- Many candidates confused surplus lines with excess layer coverage.

Part b

Candidates were expected to know what regulations surplus lines insurers are exempt from and how those exemptions benefit surplus lines policyholders.

Common mistakes included:

- Rate regulation is less strict, instead of stating that it is exempt
- Solvency regulation
- Not including the benefit to policyholders

Part c

Candidates were expected to know what regulations surplus lines insurers are still subject to.

Common mistakes included:

- Regulated by competition
- Must submit plan of coverage and rating plan to regulators