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## **Technical Advisory**

**TA 261**

**May 17, 2007**

**Subject: Hard Property Market Issues**

**Background:** *“Any port in a storm.”* Mariners throughout history have been guided by this little gem of pragmatism. For the property insurance market after Katrina/Rita, the mantra has been *“any market after the storm.”*

However, just as mariners occasionally discovered, insurance agents and their customers are finding that some of the choices in property markets can range between inadequate and downright dangerous.

Limited coverage options, restrictive terms and conditions, or outright unavailability of coverage have always been a part of the mix in placing difficult coverages or unusual risks. However, the problem has become the proverbial 500-pound gorilla in the wake of the 2005 hurricane season.

**Main Points:** Following is a discussion of some of the key issues in dealing with the hard market, including E&O concerns and loss and control procedures.

### **Surplus Lines**

Surplus lines has traditionally been the most utilized alternative to the standard market. In the hard property market, it has become the favored port of call for what had been main street property risks, pre-Katrina/Rita. Given this increased usage of the surplus markets, and the recent entry of some new surplus insurers, and increased capacity, what looks to be a safe port actually might pose dangers to agents.

**Issue #1: The “White List.”** While surplus markets are less regulated than standard markets (which are often called “approved” or “admitted” markets, but are defined in statute as “authorized insurers”), there are provisions of the Louisiana insurance code that agents must be aware of regarding the usage of surplus lines markets.

**22:1252.** *Acting as agent for **unauthorized insurer** prohibited.*

**A.** *No person shall act in this state as agent for any **insurer not authorized** to do business in this state. No person shall negotiate for or place or aid in placing insurance coverage or aid in effecting insurance or in transacting an insurance business either by fixing rates, adjusting or investigating losses, inspecting or examining risks, acting as attorney-in-fact or attorney for service of process or otherwise for any insurer not authorized to do business in this state, nor shall any person so act as an agent for another who is an applicant for insurance covering any*

*property or risk in another state, territory, or district of the United States with any insurer not authorized to transact business in such state, territory, or district, wherein the property or risk is located.*

**22:5.** *General definitions.*

**(3) "Authorized insurer"** *means an insurer with a certificate of authority or license issued under provisions of this Code or otherwise qualified under R.S. 22:2071 et seq.*

**22:5.** *General definitions.*

**(18) "Unauthorized insurer"** *means an insurer which does not possess a certificate of authority to do business in the state.*

**22:1257.** *Surplus line insurance from **unauthorized insurers**.*

*If certain insurance coverages cannot be procured from authorized insurers, such coverages, hereinafter designated as "**surplus lines**", may be procured from approved unauthorized insurers provided that the insurance is procured through a licensed surplus line broker.*

**22:5.** *General definitions.*

**(17) "Surplus lines insurance"** *means any property and casualty insurance in this state on properties, risks, or exposures, located or to be performed in this state, permitted to be placed through a licensed surplus lines broker with an **approved unauthorized insurer**.*

**22:5.** *General definitions.*

**(2) "Approved unauthorized insurer"** *means an insurer without a certificate of authority, or otherwise qualified under the provisions of this Code, and which is on the list of approved unauthorized insurers under the provisions of R.S. 22:1262.1, and from which a licensed surplus lines broker may procure insurance under provisions of R.S. 22:1257.*

**22:1262.1.** *Approved unauthorized insurers; list; requirements; removal*

**A.** *No surplus line broker shall place surplus line insurance with an insurer who is not on the **list of approved unauthorized insurers** as compiled and maintained by the commissioner of insurance.*

**Comments:** Agents must exercise extreme care and vigilance about two key requirements in the Louisiana insurance code regarding surplus lines placements. First, transact business only with licensed surplus lines brokers (22:1257). Second, be absolutely certain that the market being used is on the "*list of approved unauthorized insurers*" as required in 22:1262.1. This list is often referred to as the Department of Insurance "White List" (actual title is "Approved Unauthorized Insurer List – Surplus Lines White List") ([http://www.lidi.state.la.us/search\\_forms/white\\_list.cfm](http://www.lidi.state.la.us/search_forms/white_list.cfm)). The White List can also be linked from the Independent Insurance Agents & Brokers of Louisiana (IIABL) web site ([www.iiabl.com](http://www.iiabl.com)). At the home page, see "*Legislative & Regulatory*" section, then see the link to "LDI Surplus Lines White Lists."

At present, there are 154 insurers listed. It is important to note that an insurer who might be A-rated is not necessarily on the LDOI White List. As the property market has struggled to get its footing, some insurers have entered the marketplace that are financially strong but are not on the LDOI White List. Under section 22:1262.1., it is a violation of the Louisiana insurance code to place business with an unauthorized insurer not on the White List.

**Issue #2: Surplus Lines Stamp.** Another requirement of the Louisiana surplus lines statutes is that the insured be given written notice concerning the unavailability of the Louisiana Insurance Guaranty Association (LIGA) for surplus lines policies. This notice is often referred to as the “surplus lines stamp,” and the specifics regarding this requirement are provided in 22:1258, as follows:

**22:1258. Endorsement of contract**

A. *Every insurance contract procured and delivered as a surplus line coverage pursuant to this Part shall have stamped or printed upon it and be signed by the surplus lines broker who procured it, in bold type and the face of which shall not be less than ten-point type, the following:*

**NOTICE**

*This insurance policy is delivered as a surplus line coverage under the Insurance Code of the State of Louisiana.*

*In the event of insolvency of the company issuing this contract, the policyholder or claimant is not covered by the Louisiana Insurance Guaranty Association which guarantees only specific policies issued by an insurance company authorized to do business in Louisiana.*

*This surplus lines policy has been procured by the following licensed Louisiana surplus lines broker:*

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*Signature of Licensed Louisiana Surplus Lines Broker  
or Authorized Representative*

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*Printed Name of Licensed Louisiana Surplus Lines Broker*

B. *The notice required under this Section shall, whether stamped or printed, be distinguished in either one of the following ways:*

*(1) The notice shall be prominently displayed in the color red.*

*(2) If the notice is printed or stamped in the color black, it shall be prominently offset by a black border.*

**Issue #3: Personal Lines Affidavit.** Louisiana statutes require that a diligent effort be made to place personal lines business in the standard market, before it can be put with a surplus lines market. Such effort must be recorded on an affidavit developed by the Department of Insurance, called “Form 1263.1 – Authorized Non-Admitted Affidavit.”

The requirements for the personal lines affidavit are found in 22:1263.1, as follows:

**22:1263.1. Proof of uninsurability; affidavit**

A. *Any licensed surplus lines broker that procures a personal lines policy with an approved unauthorized insurer shall obtain from the duly licensed submitting agent or broker within thirty days of binding an affidavit on a standardized form promulgated by the commissioner of insurance which shall be maintained by the licensed surplus lines broker that attests to the diligent efforts of the agent or broker to place insurance coverage with admitted insurers and the results thereof. The affidavit shall affirm that the insured applicant for insurance was expressly advised prior to placement of insurance that the surplus lines insurer with whom the insurance is being placed is an approved unauthorized insurer, and that in the event of insolvency of the insurer, losses shall not be paid by the state insurance guaranty*

*fund, and that the coverage is being procured through a duly licensed Louisiana surplus lines broker.*

*B. As long as the personal lines policy continues to be renewed by the same approved unauthorized insurer, there shall not be a need for new affidavits at each renewal. At renewal, if the personal lines policy is placed with a different approved unauthorized insurer, then the procurement of a new affidavit will be secured in the manner outlined in Subsection A of this Section.*

**Issue #4: Financial Strength of the Surplus Insurer.** Financial solvency of insurers is a fundamental concern for everyone – agents, brokers, insureds and regulators. A provision of the Louisiana surplus lines statutes places a clear duty on brokers:

**22:1262.A.(1)** *A surplus lines broker shall not knowingly place surplus lines insurance with insurers unsound financially.*

While jurisprudence has been favorable for agents and brokers who utilize insurers on the White List, many E&O experts recommend that agents clearly spell out in writing to insureds that a surplus lines insurer is being used. Attached to this Technical Advisory is a sample letter approved by Swiss Re, IIABL's E&O insurer.

## Residual Markets

Residual markets have historically been designed as a “market of last resort.” The first modern residual market was created in 1938, as the New Hampshire Automobile Residual Market.

Whether property, auto, workers compensation, medical malpractice or otherwise, residual markets are structured to provide bare-bones, “BTN” (better than nothing) coverages and options.

Mariners who sought “any port in a storm” quickly learned to appreciate that even with the barest essentials a small deserted island may offer, it was nonetheless preferable to drifting on flotsam at sea. Insureds similarly must be informed about the limitations of a residual market, as well as the BTN purpose they serve.

**Issue #1: Louisiana Citizens.** The Louisiana Citizens Property Insurance Corporation was created in 2003, through HB 1788 (Act 1133) – legislation which was supported by the Independent Insurance Agents & Brokers of Louisiana (IIABL), and other industry groups.

Citizens provides property coverage in both personal lines and commercial lines, using standard ISO forms, with some Citizens-specific amendments. A key issue for agents and insureds to understand is that coverages and options are purposely limited to basic elements, and are not meant to fully replicate what is available in the voluntary (standard) market.

Accordingly, the perils/causes of loss, valuation basis, limits of coverage, and endorsement options are, for the most part, restricted to those terms and conditions which are provided in the unamended coverage form, such as the Homeowners, Dwelling or Commercial Property forms.

For example, the ISO Building and Personal Property (CP 00 10) provides for actual cash value (ACV) valuation to buildings and personal property. In the standard market, replacement cost valuation is almost universally available. However, in keeping with its limited scope and role in the residual marketplace, the Citizens policy does not offer replacement cost.

Likewise, the only perils that can be attached to the CP 00 10 is the Basic Causes of Loss – CP 1010. In addition, Citizens does not offer Business Income.

In the Homeowners policy, the standard ISO HO-3 provides replacement cost on buildings under Coverage A and B, with ACV on Coverage C Personal Property. Standard markets routinely provide replacement cost for Coverage C, while Citizens, by design, offers it only on the HO-2 and HO-3.

The best general rule of thumb in helping insureds understand the scope of coverage under a Citizens policy is that it will be a standard ISO form, but with few, if any, enhancements available. It is important to clarify to insureds that a residual market such as Citizens is structured, out of necessity, to be basic, bare-bones coverage, being a “market of last resort.”

**X-Wind and Wind-Only.** Excluding specific undesirable exposures from an otherwise acceptable risk is a routine function of underwriting. Whether the concern is specific drivers, products, locations, acts or perils, etc., the ability to exclude certain aspects of a risk allows the remainder of the risk to be written by the insurer.

Many states with a coastal exposure have included a provision for high-risk windstorm properties in their state residual market. Louisiana Citizens provides wind-only coverage for commercial properties

and dwellings. However, these policies do not provide replacement cost, Business Income, or Additional Living Expense.

At the same time, it is critically important for the agency to document such excluded exposure to the insured in writing. Swiss Re had approved a Wind/Hail Acknowledgement Form, which is attached to this Technical Advisory.

**Coinsurance and Contributory Insurance.** Louisiana Citizens requires a minimum of 80% coinsurance, with options for 90% or 100%. At the same time, the maximum limits available under Citizens for commercial risks (effective June 1) are: \$5,000,000 per location, \$2,000,000 on business property, and \$10,000,000 maximum per policy limit.

In situations where an insured needs to procure additional limits to comply with the selected coinsurance percentage, the CP 99 20 Contributory Insurance endorsement must be attached. For example, an insured with an \$8,000,000 building and 80% coinsurance would need to carry \$6,400,000 total insurance. Louisiana Citizens would provide \$5,000,000 and the remaining \$1,400,000 would have to be secured from another market.

The CP 99 20 Contributory Insurance endorsement would provide that each insurer pay for any covered loss on a pro rata basis.

## **E&O Issues**

Consistent, uniform adherence to sound E&O loss control procedures is a fundamental component of agency operations, day in and day out, storm or no storm. The hard property market brings high visibility and intense scrutiny to a number of issues. The implementation of practical guidelines and procedures, especially documentation, will provide insureds with the important information they need in making purchasing decisions, and at the same time bolster the agency's potential defense, should it become necessary.

The various duties an agency owes its insureds are mostly shaped by jurisprudence, since statutes provide only broad, general obligations of agents. Numerous issues of duty owed by agents to insureds are a part of the on-going post-hurricane litigation. Without question, agencies must exercise great care in dealing with the hard property market.

**Issue #1: Reduced terms and conditions/Unavailability of coverage.** Most E&O experts recommend that insureds be provided some form of written notification that a renewal or replacement policy offers reduced terms, conditions, limits or coverages. At the same time, opinions vary as to the form of notification, as well as how specific and detailed the information should be.

If the policy is a renewal in a standard commercial lines market, and the renewal has reduced terms, conditions, limits or coverages, Louisiana statute **22:636.4.E.** requires that the insurer provide written notification to the insured within 30 days of expiration.

**22:636.4.** *Commercial insurance; cancellation and renewal.*

**A.** *This Section shall apply to commercial property insurance policies and commercial multi-peril insurance policies; workers' compensation insurance, professional errors and omissions policies, commercial liability insurance policies, other than aviation and employers' liability*

*insurance policies. It shall not apply to reinsurance, excess and surplus lines insurance, residual market risks, multistate location risks, policies subject to retrospective rating plans, excess or umbrella policies, and such other policies that are exempted by the commissioner of insurance.*

***E.(1)*** *An insurer shall mail or deliver to the named insured at the mailing address shown on the policy written notice of any rate increase, change in deductible, or reduction in limits or coverage at least thirty days prior to the expiration date of the policy. If the insurer fails to provide such thirty-day notice, the coverage provided to the named insured at the expiring policy's rate, terms, and conditions shall remain in effect until notice is given or until the effective date of replacement coverage obtained by the named insured, whichever first occurs. For the purposes of this Subsection, notice is considered given thirty days following date of mailing or delivery of the notice. If the insured elects not to renew, any earned premium for the period of extension of the terminated policy shall be calculated pro rata at the lower of the current or previous year's rate. If the insured accepts the renewal, the premium increase, if any, and other changes shall be effective the day following the prior policy's expiration or anniversary date.*

*(2) This Subsection shall not apply to the following:*

- (a) Changes in a rate or plan filed with the insurance rating commission and applicable to an entire class of business.*
- (b) Changes based upon the altered nature or extent of the risk insured.*
- (c) Changes in policy forms filed and approved with the commissioner and applicable to an entire class of business.*
- (d) Changes requested by the insured.*

***F.*** *Proof of mailing of notice of cancellation, or of nonrenewal or of premium or coverage changes, to the named insured at the address shown in the policy, shall be sufficient proof of notice.*

For renewals or replacements of policies not within the purview of 22:636.4, experts recommend any of several procedures which would provide written notification to an insured.

Some coverage checklists, which experts universally recommend be used with each account, include sufficient detail as to perils/causes of loss, valuation basis, limits of coverage, and endorsement options, which would thus highlight important items to the insured.

Likewise, many insurance proposals are adequately detailed as to perils/causes of loss, valuation basis, limits of coverage, and endorsement options, and would provide an insured with notification.

Transmittal letters are also standard items experts recommend, and these can refer the insured to a copy of the coverage checklist, or insurance proposal, which would document the new terms and conditions. Alternatively, the transmittal letter itself can reference reductions or limitations in terms and conditions.

Most experts prefer a broad, general approach to such communications, rather than detailed restatements or explanations of terms and conditions. In fact, case law has generally supported the idea that insureds should read or review their policies.

While many experts favor a generalized reference to reduced terms and conditions, where a renewal or replacement policy is written with major reductions such as X-wind, or on an ACV basis instead of replacement cost, such important changes should in all likelihood be specifically addressed.

Attached to this Technical Advisory is a sample letter providing insureds with some basic information about Louisiana Citizens. Included is a chart “Louisiana Citizens – Overview of Terms & Conditions” which highlights some of the key policy provisions for both commercial lines and personal lines.

**Unavailability of coverage.** In situations where the agency has no market for an exposure, experts recommend clear, written notification to the insured.

**Issue #2: Excess or “wrap” programs.** In our free enterprise system, one person’s problem can be another person’s opportunity. As property markets gain a little traction, excess markets often develop, with some programs designed specifically to wrap around the residual market coverage. While the additional markets are vitally important, agents must use extreme caution when coordinating excess, layered, or wrap programs.

**Issue #3: Flood/Excess flood.** The important need to have documented flood rejections has gained much visibility post Katrina/Rita. The Independent Insurance Agents & Brokers of Louisiana recently issued a Technical Advisory on this subject, which included a flood election/rejection form (for both primary and excess flood), which was approved by Swiss Re. At the IIABL web site ([www.iiabl.com](http://www.iiabl.com)), select Technical Advisories, and click on TA # 256 – Documenting Flood Rejections.

**Issue #4: General guidelines for the hard market.** Swiss Re, IIABL’s designated E&O carrier, has produced an excellent document on the hard market, with 11 recommendations. A copy is attached to this Technical Advisory.

**Necessary Action:** Circulate this Technical Advisory to all appropriate agency staff.

**Attachments:**

1. Swiss Re sample letter: “Wind/Hail Acknowledgement Form.”
2. Swiss Re sample letter: “Disclaimer - surplus lines.”
3. Sample letter – Louisiana Citizens/Overview of Terms & Conditions.
4. Swiss Re document: “Commercial Insurance – Hard market.”



## Windstorm/Hail Acknowledgement Form

Property policies, such as homeowners policies, dwelling policies, and commercial property insurance policies may exclude coverage for windstorm and hail events (including, but not limited to, hurricane and tornado). As your insurance agency, we strongly recommend that you purchase this important coverage. It is possible that coverage as recommended below may not be available from the carriers we represent.

\_\_\_\_\_

I hereby acknowledge the acceptance, rejection, or unavailability of windstorm and hail coverage as indicated below. It will be conclusively presumed this election, rejection, and/or acknowledgement of unavailability will apply to all future renewals, continuations, changes or replacements thereof.

<u>Type Coverage</u>	<u>Accept</u>	<u>Reject</u>	<u>Unavailable</u>
Building Coverage	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Business Personal Property	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Business Income/Extra Expense	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

\_\_\_\_\_  
Applicant's Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Location of Property

\_\_\_\_\_  
Agent/CSR Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Name of Agency

**(Disclaimer letter for your use of a surplus lines carrier)**

Current Date

Mr. John Q. Client  
123 Main Street  
Anywhere, TX 78701

Dear Mr. Client:

At your request, your coverage has been **[placed or quoted]** with **(name of company)**. This insurer is currently a surplus lines company and is rated by A.M. Best Company, a leading monitor of the financial performance and stability of insurance companies. A rating by the A.M. Best Company is an indication of the insurance company's financial strength and operating performance, with the top rating being A++ (Superior).

Our agency, generally, does not place coverage through any insurer that is a surplus lines company. However, based on our search of the insurance marketplace and with your authorization, we will place your coverage with **(name of company)** at the premium amount outlined in our proposal.

While A.M. Best Company's rating of **(name of company)** reported it was financially stable at the time it was reviewed, this is no a guarantee of future performance. In addition, while **(name of company)** is authorized to provide insurance, it is a "surplus lines" insurance company. This means that you will not be able to collect from the state insurance guaranty fund in the event **(name of company)** becomes insolvent.

We are not experts in the financial analysis of insurance companies. Should this company become unable to satisfy its obligation to pay claims; our agency will not be held responsible for the insolvency of the carrier.

Please sign below and return this letter. By signing, you acknowledge that you have read this letter and we have reported to you the insurance company you have selected to provide your coverage is a surplus lines company.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Signature of Insured

\_\_\_\_\_  
Printed Name

Sincerely,

[Signature]

## **Louisiana Citizens Property Insurance Corporation Information for Policyholders**

The Louisiana Citizens Property Insurance Corporation was created by the Louisiana Legislature in 2003 (Act 1133), in response to a difficult property insurance market in Louisiana.

By design, residual markets such as Louisiana Citizens are created to provide only limited coverages, terms and conditions. They are purposely not designed to offer the broader range of insurance coverages and options available in the voluntary market.

The attached chart provides a broad overview of the terms and conditions of policies written through Louisiana Citizens.

As with any insurance policy, it is important to review the policy. If you have any questions as to specific coverages, terms or conditions of your Louisiana Citizens policy, please let us know.

**Louisiana Citizens**  
**Overview of Terms & Conditions**  
 June 1, 2007  
**Part 1 – Commercial Property Policies**

<u>Item</u>	<u>Std. Policy</u>	<u>Option</u>
Valuation – Building	ACV	None
Valuation – Contents	ACV	None
Causes of Loss:		
Multi-Peril	Basic CP 10 10	None
Wind/Hail	FP-CP 95-1	None
Max. Limits – Building/Location	\$5,000,000	None
Max. Limits – Contents	\$2,000,000	None
Max. Limits – Policy	\$10,000,000	None

Coverage Forms Available:

- CP 00 10 – Building and Personal Property Coverage
- CP 00 20 – Builder’s Risk
- CP 00 17 – Condominium Association Coverage
- CP 00 18 – Condominium Commercial Unit Owners Coverage
- CP 13 10 – Value Reporting Form
- CP 13 60 – Report of Values
- CP 99 20 – Contributory Insurance

Significant Coverage Forms & Options **Not** Available:

- Business Income
- Ordinance & Law
- Off-Premises Utility Failure
- Debris Removal –Additional Limit
- Blanket Coverage
- Replacement Cost
- Theft
- Agreed Value
- Inflation Guard
- Broad Form or Special Form Causes of Loss

Special Conditions:

80% Coinsurance required (90% or 100% optional)

**Louisiana Citizens  
Overview of Terms & Conditions**

June 1, 2007

**Part 2 –Personal Lines Policies**

**HOMEOWNERS**

(Forms HO-2, 3, 4, 6, 8)

<u>Item</u>	<u>Std. Policy</u>	<u>Option</u>
Valuation – Building (HO-2,3,6)	RC	None
Valuation – Building (HO-8)	RC/FRC	None
Valuation – Contents (all forms)	ACV	HO-2&3: RC
Max. Limit – Building (HO-2&3)	\$750,000	None
Max. Limit – Building (HO-6&8)	\$350,000	None
Max. Limit – Contents (HO-2, 3 & 8)	50% Cov. A	None
Max. Limit – Contents (HO-4 & 6)	\$175,000	None
Section II Liability	\$100,000	\$200/300,000
Section II Medical Payments	\$1,000	None

Significant Coverage Options Available:

Personal Property Replacement Cost – HO 2 & 3 only. (HO 04 90)

Increased Section II Liability limits – \$200,000 or \$300,000

Alarm Credit (HO 04 16)

Other Structures – Increased Limit (HO 04 48)

Significant Coverage **Not** Available:

Increased Ordinance & Law coverage (HO 04 77)

Scheduled Personal Property (H0 04 61)

Increased Coverage C – Other Residence (H0 04 50)

**Louisiana Citizens  
Overview of Terms & Conditions**

June 1, 2007

**Part 2 –Personal Lines Policies**

**DWELLING**

(Forms DWG-1, 2, 3)

<u>Item</u>	<u>Std. Policy</u>	<u>Option</u>
Valuation – Building (DWG-1)	ACV	None
Valuation – Building (DWG-2, 3))	RC	None
Valuation – Contents (all forms)	ACV	None
Max. Limit – Building	\$750,000	None
Max. Limit – Contents	\$150,000	None
Max. Limit – Contents – No Cov. A	\$150,000	None

Significant Coverage Options Available:

Coverage B may be increased to 25% of Coverage A limit

Significant Coverage Options **Not** Available:

DWG-1 – no Additional Living Expense

DWG-1 – No replacement cost valuation for any covered property (building or contents).