

**SURPLUS LINES ASSOCIATION OF COLORADO
SURPLUS LINES PRODUCER TEST
STUDY GUIDE**

The Colorado Pre licensing examination is based upon Article 5 of the Colorado Insurance Code and Regulation 2-4-1. Both of these documents can be found in their entirety at our website www.colosla.org under the Statute Section

Colorado requires that for residents to procure a surplus lines license they must do three things:

- 1) Be in the possession of a current Colorado Producers Property/ Casualty license
- 2) Pass a multiple choice examination administered by Promissor
- 3) Complete an application and pay a fee.

Non residents are not required to pass an examination.

The purpose of this document is to provide an overview of Colorado Surplus Lines Laws to prepare applicants for the examination.

- A) Article V of the Colorado insurance code provides the legal basis for surplus lines insurance placements. Regulation 2-4-1 provides additional information.

10-5-101.1 Legislative Declaration. States that the purpose of the statute is to control, regulate, supervise and tax property and casualty policies that are placed in the non admitted market. Workers Compensation, Accident and Health, Surety policies may not be placed in the non admitted market. The declaration also states that the intent of Article V is to regulate and control the flow of insurance to non admitted insurers, to protect revenues and protect the licensed insurers from unfair competition. This unfair competition comes from the fact that

non admitted insurers are not governed by set policy forms or rates.

10-5-1-1.2 Definitions. This section simply clarifies what each of the terms mentioned in the Statute means

- 1) “Broker” individual with a surplus lines license. In Colorado all transactions are recorded under the individuals license not a corporate license. As such the individual is personally responsible for all taxes and, if their license is used by the corporation to record taxes, for any violations and penalties.**
- 2) “Export” the act of placing insurance with a non admitted insurer.**
- 3) “Non Admitted Insurers” Insurers who are permitted to insure Colorado risks without having to file rates, forms or comply with the rules that licensed insurers are required to conform to. Nevertheless non admitted insurers can be the subject of unfair trade practice suits brought in the state.**
- 4) “Surplus lines insurance” means policies placed with nonadmitted insurers.**

10-5-101.5 Exemptions This ambiguous portion of Article is intended to clarify which types of insurance risks are not subject to the provisions of the law. The first sentence of this section should be interpreted as meaning that the exempted risks listed are not subject to the utilization of approved non admitted insurers but does not mean that surplus lines tax is not charged. The types of risks noted are:

- A) Reinsurance**
- B) Marine Hull,Cargo,P&I,War**
- C) Risks located outside Colorado or Aircraft and vehicles garaged outside the State.**
- D) Interstate Railroads**
- E) Commercial Airlines, Aircraft Manufacturers.**

Brokers are required to maintain records of each transaction of these types for a period of three years.

When using a non white listed insurer for these particular categories of risk the following disclosure must be placed upon the policy.

10-5-102 Validity of Contracts. This provision simply states that a non admitted insurer cannot void an insurance contract because of a violation of the insurance code. For example if a non admitted company was not on the approved “white list” they could not use that as a defense for not paying a loss by claiming that they had no status in Colorado. On the other hand a consumer, learning of this circumstance, could void the contract and demand a full return of their premium.

10-5-103 & 10-5-103.5 Conditions for Export. This section defines the requirements for an insurance policy to be placed with a non admitted insurer:

- 1) The policy must be placed by a licensed surplus lines broker.
- 2) The insurance is not available from a licensed insurer. In order to determine this the surplus line broker, or their retail agent, must have performed “due diligence”. Due diligence is the act of contacting at least 3 licensed companies who insure that particular class of business and having them decline it. The statute does not require that declinations be in writing but the broker or retail producer must be able to present reasonable evidence that due diligence did take place.
- 3) In Colorado it is permissible to place a risk with a non admitted insurer on the basis of price provided that the price differential is greater than 10% and the policy terms offered by both the licensed insurer and the non admitted insurer are the same. For example if a non admitted insurer’s premium is 15% less but their deductible is \$5,000 higher the risk may not be placed with the non admitted insurer because there is no compatibility between the terms. If the deductible were the same or less then placement would be valid.
- 4) Due diligence is not required in the case of “exempt commercial policyholders” who are deemed to be sophisticated insurance buyers who understand the difference between licensed insurance placements and non

admitted insurance. This class of insured is defined in 10-4-1402 and meets the following criteria:

- 5) Under the terms of current law surplus lines brokers must file a monthly report and affidavit with the Colorado Division of Insurance verifying the details of the transaction and that due diligence was performed.**

10-5-104 & 10-5-119 Endorsement of Contract

**Every contract (which can be interpreted as every binder, covernote or policy) placed with a non admitted insurer shall carry the following disclosure stamped upon it;
“ This contract is delivered as surplus lines coverage under the “Non Admitted Insurance Act”. The insurer issuing this contract is not licensed in Colorado but is an approved nonadmitted insurer. There is no protection under the provisions of the “Colorado Insurance Guaranty Act”. This endorsement shall be accompanied by the name or initials of the surplus lines broker.**

If the policy is a claims made contract it also has to carry the following endorsement;

“This policy is a claims made policy which provides coverage only if a claim is made during the policy period or any applicable extended reporting period”

10-5-105 Surplus Line Insurance Valid

This section, which appears to be an addendum to 10-5-102, simply states that insurance contracts created under the provisions of this Article shall have the same force in law as though it were issued by a licensed insurance company.

10-5-106 When export declared eligible.

Some States operate on the assumption that some types of insurance risk are so hazardous (IE fireworks manufacturers, pollution liability) that only non admitted insurers will insure them. Therefore they waive the requirement that producers

attempt to place the risk with licensed insurers. Risks of this type are placed on an “Export List”.

Although Colorado does not have an “Export list” this provision gives the commissioner the authority to make any type of risk eligible to be written with a non admitted insurer without having to conduct the “due diligence” specified earlier. In only one instance has this happened and that is in the case of exempt commercial policyholders.

10-5-107

10-5-108 Brokers May Accept Business from Producers

The main purpose of this is to allow brokers to pay commissions to their retail producers.

While we are on the subject of commissions this is a good time to refer to a separate part of the insurance code () that specifically addresses brokers. In Colorado it is unlawful for producers to charge fees except under specific conditions.

“Wholesale producers” are exempt from this provision and may charge fees provided they notify the retail producer with the following disclosure:

10-5-109 Placement of surplus lines insurance

This long section is dedicated to stating that brokers can only place nonadmitted insurance with insurers that have been approved by the State and sets out the conditions for approval. In Colorado, as in most States, non admitted insurers fall into two categories, Foreign insurers and Alien insurers. Foreign insurers are those insurers who are domiciled within the United States but are headquartered in another State. Alien insurers are insurers that are domiciled in another country.

Here are the requirements for approval in Colorado:

Foreign insurers are US based companies that are domiciled in a State other than Colorado.

Alien insurers are companies that are based overseas

All insurers requesting to be approved to write surplus lines insurance in Colorado must apply annually and complete the application. In addition they must pay a fee based upon

Colorado premiums written in the prior year plus a surcharge for fraud investigation.

Foreign insurers:

- 1) Be able to provide a Certificate of Deposit issued by the domicile State showing a market value of at least \$2,500,000 for the benefit of all U S policyholders.**
- 2) Be able to provide a Certificate of Authority issued by the domicile State showing the lines of insurance that the company is approved to write as a licensed insurer in that State.**
- 3) Be able to show evidence of good repute and financial integrity. The latter is achieved by providing an Annual Statement from the prior year.**
- 4) Be able to show a minimum policyholder surplus of \$15,000,000. Under certain circumstances the commissioner has the authority to accept a company that does not meet this minimum amount.**
- 5) Provide a copy of an Actuarial Statement**

Alien Insurers

- 1) Have already been approved by the NAIC and received a NAIC code.**
- 2) Be able to provide evidence of a Trust account, with an Approved U S Institution, in the amount of a minimum of \$5,400,000 market value for the benefit of U S Policyholders.**

Lloyds and similar type organizations.

Although Lloyds is technically an Alien Insurer Colorado has special rules for their approval. In part this is because of the fact that Lloyds is really a conglomeration of insuring entities and not a single operation. The Lloyds Trust Fund must be in the amount of at least \$100,000,000. In addition Lloyds must maintain an amount that is required by the state of New York which is where the Trust fund is located and administered .

An important feature to this section is that brokers who place insurance with an insurer that has not been approved by the commissioner is liable for a fine of up to \$10,000 and the possibility of having their license revoked.

10-5-110 Records of Surplus Lines Broker

As a surplus lines broker you are expected to maintain accurate records that may be examined at any times by the commissioner. These records should include:

- 1) Evidence of due diligence or details of the party responsible for conducting the search.**
- 2) A copy of the daily report which shows:
Name and address of insurer
Name and address of insured
Brief description of risk insured and location
The amount of insurance
Gross premiums charged
Rates charged on property
Effective date of the policy
Other information as may be required by the commissioner**

10-5-111 Annual Statement

Each year every surplus lines licensee has to submit to the commissioner an Annual Statement which includes Gross premiums, returned premiums paid and aggregate net premiums.

In reality the Division of Insurance prepares an Annual Statement for each licensee which is revealed once the December report has been submitted. It is based upon the monthly reports submitted by the producer and forms the basis of the tax payment.

10-5-112 Tax on Premiums

Taxes are charged on every non admitted insurance policy but only on those portions of multi state risks that are

located in Colorado . The Colorado DOI report system requires that both the gross premium and the Colorado allocated premium be provided. The tax rate is 3% and it is calculated on the gross premium plus any fees paid by the insured. (Article 5 states that it is calculated on net premiums and because of confusion over verbage some brokers have interpreted this as being after commissions. This is incorrect)

Taxes are paid no later than March 1st of the following year.

10-5-113 Penalty for Failure to Comply

Licensees who do not pay their tax liability by April 1st (30 day grace period) are subject to a fine of \$25 per day.

10-5-114 Revocation of Brokers License

The commissioner has the right to revoke the license of a surplus lines broker for a number of reasons:

- 1) They fail to file their Annual Statement or pay their tax.
- 2) They fail to maintain appropriate records
- 3) For any of the causes for which a general brokers license may be revoked or whenever the commissioner believes that revocation is in the best interest of the people of the state.

10-5-115 Actions Against Insurer - Service

This is the service of suit provision that allows a non admitted insurer to be sued in the state. It also adds that the service of suit may be made upon the commissioner