

PENNSYLVANIA SURPLUS LINES ASSOCIATION MEMBER SERVICES

Summer 2007

Pennsylvania Surplus Lines Association Newsletter

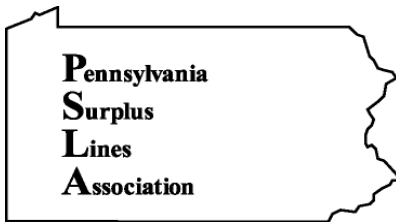
Electronic Filing System

PSLA Executive Director, Ken Rudert reports that the Electronic Filing System that was implemented in June, 2006 has received very positive reaction from the surplus lines community, including both resident and nonresident surplus lines licensees. Rudert further indicated that many licensees have not been converting to the new filing process as rapidly as had been originally expected. Presently, the use of the Electronic Filing System is strictly voluntary, but the increased cost to the Stamping Office to operate both the new electronic filing process and to maintain the old manual data entry process has prompted much discussion.

Out of approximately 2,000 surplus lines agencies, including the many branch offices, about 25% are now registered to file electronically. PSLA's records indicates that approximately 350 agencies are active on a regular basis but only 20% of the total transactions are entered electronically. The fact that electronic filing has not been utilized more by licensees has been disappointing and the additional cost of maintaining both an electronic and a paper filing system may result in an increase in the current reasonable flat stamping fee which has been in effect for almost six years.

Rudert says that it is unrealistic to believe that the Pennsylvania Insurance Department would approve an excessive stamping fee increase merely because licensees are not using the Electronic Filing System more frequently. He suggests it would seem more realistic to consider the use of other supplemental charges not paid by the insured in addition to a more modest reasonable stamping fee increase.

Rudert's advice is you should convert to the Electronic Filing System as soon as practicable. Further, he suggested that surplus lines licensees view the information on the subject of electronic filing on PSLA's web site. This section on PSLA's web site includes a provision to participate in their monthly WebEx workshops and to review the Procedures Manual devoted exclusively to this subject. Also, he reminded that one keep in mind that this system goes beyond just the surplus lines filing process. This system also enables the user to file endorsements reflecting additional and return premium traffic as it occurs plus the monthly reports and the annual tax filing. All of this is of great assistance to the surplus lines licensee in the interest of properly monitoring one's own individual activity and compliance.



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Federal Legislation

Nonadmitted and Reinsurance Reform Act of 2007

The House on June 25, 2007 unanimously passed legislation reforming regulation of the surplus lines and reinsurance markets.

H.R. 1065--the Nonadmitted and Reinsurance Reform Act of 2007--gives the home state regulator of the insurer primary oversight of multi-state surplus lines risks.

Under the bill, the home state regulator would also be responsible for allocating any taxes collected on the coverage to the other involved states. The legislation makes it easier for sophisticated purchasers to access the surplus lines market.

Primary sponsors of the legislation are representatives Dennis Moore, D-Kan., and Ginny Brown-Waite, R-Fla.

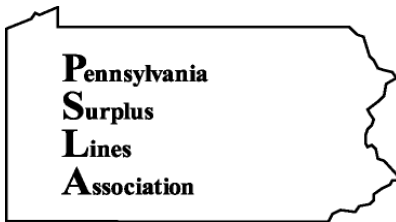
The industry was highly supportive of the bill. A bill similar to HR 1065 the legislation passed the House last year by a vote of 417-0. The Bill is a recognition that the duplicative and conflicting system of state regulation was making compliance difficult if not impossible, and that a congressionally-imposed solution was needed. The bill not only eliminates duplication in surplus lines regulation but can also serve as an example of how responsible insurance reform can occur—by using targeted federal legislation to address areas of concern while retaining the strengths of the current regulatory system.

While the bill had strong insurance industry support, some groups' reaction displayed the ongoing tension over the topic of regulation as a whole.

Similar legislation--S.929--was introduced in the Senate in February by Florida's senators—Democrat Bill Nelson Republican Mel Martinez--but the Senate bill will likely need upgrading to reflect changes added at the request of the Risk and Insurance Management Society that ensures the definition of "Qualified Risk Manager" is sufficiently broad to include as many RIMS members as possible.

Surplus Lines Insurance Multi-State Compliance Compact

The Nonadmitted and Reinsurance Reform Act of 2007 provides that the States may enter into a compact or otherwise establish procedures to allocate among the States the premium taxes paid to an insured's home State.



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A drafting group composed of regulators, brokers, Stamping Offices, and carriers have been meeting regularly to draft a Surplus Lines Insurance Multi-State Compliance Compact. Ultimately the goal is for the States to adopt the Compact as state law. The Compact continues to evolve and the final form is expected to be completed for the Fall NAIC Meeting.

National Flood Insurance Program

Plans by Democratic lawmakers to alter a National Flood Insurance Program reform bill by adding language allowing NFIP to provide windstorm coverage is creating concern among insurers.

The windstorm coverage provision in the legislation introduced on July 20th is based on language in H.R. 920, a bill authored by Rep. Gene Taylor, D-Miss., that also would have expanded the NFIP to include windstorm coverage.

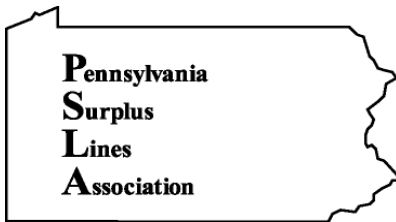
Industry groups representing property-casualty companies have maintained a strong opposition to the NFIP expansion proposed by Rep. Taylor, arguing that a strong private market for wind coverage already exists. Additionally, the groups have questioned whether the Taylor legislation's requirement that windstorm coverage be offered at actuarially sound pricing will be able to withstand political pressure to lower rates for homeowners. However, Allstate and Nationwide are bucking a large insurance industry segment by throwing their support behind some form of expansion of the National Flood Insurance Program to include windstorm coverage.

The Bush administration flatly opposes expanding the National Flood Insurance Program to include windstorm coverage, a Treasury official told a House subcommittee today, placing a major roadblock in the path of legislation to expand the program.

Other reforms already contained in the flood program reform legislation would call for a study of expanding the mandatory purchase requirement for flood insurance to the natural 100-year floodplain, and for the phasing out of subsidized rates for nonresidential properties or secondary homes.

Terrorism Risk Insurance Revision and Extension Act of 2007

After the 9/11 terrorist attacks, many insurance companies excluded terrorism events from their insurance policies. As a result, Congress in 2002 passed TRIA, which created a federal backstop to protect against terrorism related losses. In 2005, the measure was extended for two years and currently is set to expire at the end of 2007



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The House Financial Services Committee's Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee is expected to begin marking up the Terrorism Risk Insurance Revision and Extension Act of 2007 early next week, according to industry sources. The full committee could take up the measure as early as next week as well.

The bill extends the Terrorism Risk Insurance Act (TRIA) for 10 years and, its supporters contend, will spur the development of a private market for terrorism risk insurance.

The Terrorism Risk Insurance Revision and Extension Act of 2007 (TRIREA) includes provisions to:

- Extend TRIA for 10 years with current co-payments and deductibles for conventional terrorism acts;
- Expand TRIA's "make available" requirement to include NBCR coverage;
- Change TRIA's definition of terrorism to include acts of domestic terrorism;
- Set the program trigger at \$50 million;
- Add group life insurance to the lines of insurance for which terrorism coverage must be made available;
- Decrease deductibles and triggers for areas previously impacted by a significant terrorist attack; and,
- Continue to require studies of the development of a private market for terrorism risk insurance.

Optional Federal Charter

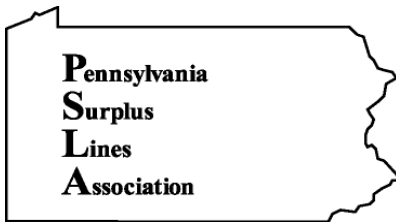
On May 24, 2007 Senators Sununu and Johnson introduced S. 40, the National Insurance Act of 2007.

The supporters of the idea of offering insurance agencies and companies an Optional Federal Charter (OFC) as a regulatory alternative state this is in response to the lack of uniformity and efficiency in the current state regulatory system and an attempt to create a mechanism for improving the speed with which insurance products can be brought to market. Creating an OFC is also an attempt to bring the benefits of market economics to the insurance industry by allowing markets to establish rate and product design.

The highlights of S. 40 are:

Unified Federal Regulator

The proposal establishes a federal insurance office in the Treasury department that would



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be vested with the authority to charter national companies and agencies and to implement the statute governing their activities. This office, and the single appointed regulator responsible for its activities, would regulate solvency, market conduct and accounting of federally chartered entities.

□ Unified Licensing Authority

The federal insurance regulator would be solely responsible for chartering and licensing federal insurance entities by line of business. Conversely, states would retain the ability to license insurance entities that wished to remain state governed institutions.

□ Rate and Form Deregulation

The proposal would not impose rate regulation on federally chartered companies nor would it

allow the federal regulator to require prior approval of forms.

□ Federal Preemption

The proposal would rely on strong, federal preemption to create a regulatory framework based on a single set of federal rules, instead of a patchwork of multiple state rules, for those that elect the federal regulatory option.

□ McCarran-Ferguson Repeal

The OFC proposal would repeal the McCarran-Ferguson Act's anti-trust exemption for those entities that elect to operate under a federal charter and, thus, would subject them to regular Sherman Act restrictions.

□ Unified Guarantee Mechanism

The proposal relies on the continued operation of the state guarantee fund system and only resorts to a federal mechanism should an individual state's system not meet certain minimum requirements.

□ Safeguards State Premium Tax Revenue

The proposal relies on participants in the federal charter to shoulder the costs of the federal charter. Premium taxes, currently estimated at \$12 Billion annually, would continue to be collected by the states in which the premiums are drawn.

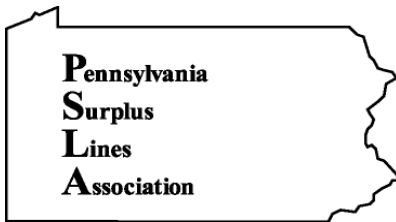
However, significant segments of the insurance industry are not in favor of the OFC concept. These parties recognize that the state insurance regulatory framework must be modernized and streamlined, however, they believe that state regulation addresses the unique regional problems facing the insurance market.

We will keep you advised on the progress of OFC in Congress.

Pennsylvania Insurance Issues

Medical Malpractice Insurance Limits

Because of inadequate commercial insurance capacity, Pennsylvania health care providers will not have to boost their commercial medical malpractice insurance limits



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and reduce their dependence on a state fund for coverage, the state's insurance department has announced.

Providers in the state currently are required to maintain \$1 million of coverage, with the first \$500,000 of limits purchased from a commercial insurer and an excess layer of \$500,000 obtained from the state's Medical Care Availability and Reduction of Error Fund.

Under state law, as commercial market capacity increases, providers would have to purchase \$750,000 of commercial limits and \$250,000 of state fund limits. Eventually, the state anticipates requiring providers to purchase all of their limits in the commercial market.

An actuarial study by PricewaterhouseCoopers L.L.P. shows that the state's medical malpractice insurance market has improved since the enactment of various reforms in recent years, noted Deputy Insurance Commissioner Randy Rohrbaugh in a statement. But, based on the study, commercial market capacity has not increased sufficiently to require providers to purchase additional commercial limits, Mr. Rohrbaugh said he has determined.

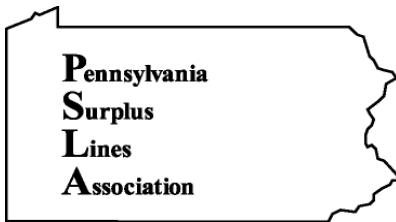
Pennsylvania Insurance Department Enforcement Actions

In RE First Commonwealth Insurance Agency, Inc.

First Commonwealth Insurance Agency, Inc. ("Respondent") was a licensed insurance producer but did not possess a Pennsylvania surplus lines license. Between 2002 and 2006, Respondent procured eight surplus lines policies, but failed to ensure its actions were in compliance with Pennsylvania insurance laws and regulations. Respondent failed to submit surplus lines filings to the Pennsylvania Insurance Department. Respondent failed to submit surplus lines taxes to the Pennsylvania Department of Revenue for eight of the surplus lines policies for years 2002 through 2005, totaling \$40,223.28. Respondent remitted the surplus lines taxes to the Pennsylvania Department of Revenue on February 28, 2007.

Respondent and the Pennsylvania Insurance Department consented to the following:

- Respondent shall pay a civil penalty of \$4,000.00
- For a period of three years Respondent agreed that its licenses may be immediately suspended following a determination that any



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complaint against Respondent is accurate and a statute or regulation has been violated.

2007 Annual Meeting

The 2007 Annual Meeting of the PSLA was held on April 12-13, 2007 at the ACE Conference Center in Lafayette Hill, Pennsylvania. Stephen Johnson, Deputy Insurance Commissioner of Pennsylvania, presented his assessment of surplus lines insurance issues and discussed the status of the Surplus Lines Insurance Multi-State Compliance Compact. The Keynote speaker was Rob Fishman, CEO of United American Group. Mr. Fishman gave an informative and candid assessment of how the surplus lines market would affect his company. He discussed the challenges which confront surplus lines insurers.

Ken Rudert, Executive Director of the PSLA, presented his report on the stewardship of the Pennsylvania Surplus Lines Association Advisory Organization. Ken reported that in spite of some surprises and unforeseen circumstances, the status of the Stamping Office's operations were in relatively good order.

On Thursday night the attendees gathered for a networking reception which was followed by a Casino Night to celebrate the Twentieth Anniversary of the PSLA Membership Division. Everyone had a great time enjoying the mock gambling.

The second day of the Annual Meeting began with a Panel Discussion of knowledgeable surplus lines lawyers who discussed various topics, including the status of pending Federal legislation on the surplus lines marketplace and how brokers can access the Lloyds market. Attendees were engaged and asked numerous questions. Following the Panel Discussion PSLA staff presented an Electronic Filing Procedures Workshop and Bernie Heinze, Esq., who is the CEO of Accolade Management Inc, the company which provides management services to the Membership Division, led two courses approved for Pennsylvania continuing education credits were offered.

SAVE THE DATE!

The 2008 Annual Meeting will be held in Pittsburgh, Pennsylvania in April 2008. Although the dates have not been finalized as of this Newsletter, members will be informed as soon as the dates are fixed.