

# Risk Monitor



## Taking the Mystery Out of Surplus Lines

It is probably safe to say that most people do not know the difference between “surplus” (also referred to as Non-Admitted, E & S or Excess & Surplus) and “admitted” lines. However, understanding the important similarities and differences will help make you an informed insurance consumer.

Many insurance consumers are completely untouched by the surplus lines marketplace. Still others purchase coverage from surplus lines carriers unaware of that fact. If you buy coverage from a Lloyds of London syndicate, you may think you are simply buying from a foreign insurer, but in fact, you may be buying coverage from a US based subsidiary of a large insurance company.

Surplus lines insurers operate in hard and soft markets, but they thrive when admitted companies withdraw from the marketplace leaving them to fill the void in certain coverage lines. According to the National Association of Professional Surplus Lines Offices, Ltd.(NAPSLO), while the property/casualty industry grew by 11% during 2001, the surplus lines portion of the industry grew by nearly 35%, reflecting the hardening of the market and the contribution of the events of 9/11.

### Following are a few highlights of the differences between surplus lines and admitted:

- Admitted insurers usually have to file and receive approval for their rates and policy forms in most states they operate in. Some states only require that rates be filed, others require only forms. Some require the insurer to withhold a product from the marketplace until they have received approval. Other states allow what is called “use and file” meaning the insurer is free to use the form and rates, but must file them with the state and if necessary, make any changes that the state requests in order to comply with its rules and regulations. Surplus lines insurers do not have to go through this rigorous process and can react more quickly to changing internal and external conditions and events.
- Surplus lines insurers must work with surplus lines brokers to comply with certain state required filings such as surplus lines taxes, which vary, but usually range between 2 - 4% of the premium.

Surplus lines brokers also file affidavits acknowledging what is called a diligent search that states the insured risk was submitted to the admitted market but received declinations from those specific carriers. Admitted insurers bear the responsibility of paying whatever state taxes are required. These taxes are figured into their pricing models so the premium you pay includes any tax payable to the state. In the case of surplus lines, all taxes and fees are built on top of the basic premium.

- Admitted carriers must comply with state requirements for policy language, most notably, cancellation and non-renewal requirements. While most admitted policies require a 30 or 60 day notice to the insured if the carrier intends to cancel or non-renew the policy, most surplus lines insurers reserve the right to cancel or non-renew for any appropriate reason. Despite this difference, and the language to this effect built into the admitted policy, surplus lines insurers are in many states required to adhere to the same standards. Despite the freedoms they enjoy, there are myriad rules and regulations that surplus lines insurers must contend with, including a rigorous and costly state licensing system that puts the insurer on the map as a “white-listed” carrier.
- Probably the most noticeable difference between the two insurance types is the availability of funds to pay for claims should the carrier become insolvent. If you buy a policy from a surplus lines insurer, you should be aware that the state guaranty funds will not apply should your carrier’s insolvency leave you stranded when a claim occurs. Not so with admitted carriers. However, NAPSLO points out that in 2002, as has been the case in previous years, the median Best’s Rating for surplus lines carriers was A, versus the industry as a whole, which maintained a median rating of A-. Naturally, it becomes more important to monitor your carrier’s rating with a surplus lines policy.

While the differences are many, the nuts and bolts of both types of policies are virtually identical. Different compliance endorsements attached to admitted or surplus lines policies will be the only differences you notice. While the preference, all other things being equal, should always be admitted, there are many reasons to feel comfortable with a surplus lines policy, particularly if it is backed by a financially sound and stable insurance company. Many surplus lines companies have been paying claims for decades, and in some cases, centuries!

### You may be liable if employees do business by car phone.

You want your managers to stay productive, so you suggest they get wireless phones. You may even buy phones or reimburse for them. This is fine, as long as the employees don’t drive carelessly. In a Pennsylvania case, a Smith Barney broker who allegedly was talking on his cellular phone dropped it, bent down to get it, ran a red light and killed motorcyclist Michael Roberts. Smith Barney agreed to pay \$500,000 to Robert’s family, who sued the firm for contributing to the accident. Despite the company’s big settlement, it argued that the accident occurred outside the scope of employment-at 9:30 on Saturday night. And the firm didn’t own the phone of the car. (Roberts v. Smith Barney, E.D. Pa. No. 97-CV-2727)

If you expect staffers to use car phones for business, be sure to write a policy that requires them to pull over while they talk.

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# Sarbanes Oxley – Making the Corporate Jungle Safer?

Depending on whom you talk to, the Sarbanes-Oxley Act of 2002 was either a panacea to cure the ailing stock market and restore trust in Corporate America or a shot to the bow of America's capitalist vision. Just what is Sarbanes-Oxley and whom does it affect?

Sarbanes-Oxley is a complex patchwork of legislative reform of the American system of corporate governance, legal counsel and financial oversight of publicly traded companies.

## Among the key implications of the Act:

- CEOs and CFOs must certify the financial reports of their companies and face stiffer penalties for knowing or willful violations, including personal liability for noncompliance.
- Added disclosures are required on the company financials.
- The SEC must adopt new rules requiring that independent audit committees be created that are authorized to engage advisors.
- New criminal and civil penalties for directors and officers for, among other things, destroying or changing records and knowingly executing a scheme to defraud investors.
- Takes away some of the self-policing capability of the accounting industry by creating a five member Public Company Accounting Oversight Board, which is overseen by the Securities Exchange Commission.
- Similar to the effect on the Accounting Profession, the Legal profession is hit with new regulations, some of which run counter to the self-policing activities of the state bars and presents lawyers with the conundrum of trying to comply with the law while retaining a main cornerstone of the legal profession - attorney client privilege.

Some say Sarbanes-Oxley has had a chilling effect on the American Dream. Where the rallying cry of the '90's was "Go public!," Sarbanes-Oxley might have turned that into "Go private!" for the future, particularly for the small public companies for whom the new regulations create a cash drain. But, despite the lure of going private, some insurance industry and legal experts theorize that Sarbanes-Oxley's effect on public company accounting will put a new onus on private companies as well. They recommend that private companies follow some of the same rules on a voluntary basis to avoid potential common law negligence.

Sarbanes-Oxley's exacting standards have had a dramatic impact on the Directors and Officers Insurance market, which was already reeling from the effects of corporate scandals, and the shrinking of capital in the reinsurance marketplace that was

sharpened by the effects of 9/11. Rates have gone up dramatically and capacity has shrunk, leaving some companies underinsured when they need it most.

Accountants, particularly CPAs that do public audit work, have felt similar effects. Fewer companies today are willing to write Accountants Professional Liability for such firms. The same goes for law firms that specialize in securities law.

Perhaps the most disconcerting aspects of Sarbanes-Oxley, at least for corporate officers, are the punitive provisions for knowingly or willfully committing "white-collar" crimes. The problem with discerning the effects of these provisions is the difficulty in assessing culpability. It is possible that fingers might point at parties, who should have known what was going on during their watch, but did not "knowingly" or "willfully" perpetrate a fraud. The line between benign incompetence and intentional acts might be blurry at times, but directors and officers still face the risk of being caught in the maelstrom of public outrage.

The best advice that anyone can be given, who is entertaining the notion of becoming a board member of a public corporation, is think twice. Make sure you know that the company has adequate D & O Insurance with a reputable carrier, and the coverage provides defense against fraud allegations until guilt is proven (in many cases the insurer will settle out of court before guilt becomes a factor in coverage determination). Moreover, make sure that the limits are adequate for the size of the company. Although there is no one rule of thumb for adequate limits, most public companies should have at least \$25 million in coverage to afford adequate protection. The Microsoft's and IBM's of the world should obviously carry much more.

Private companies can purchase D & O Insurance too, often at more reasonable prices, and with a host of other pertinent coverages such as Employment Practices Liability, Kidnap & Ransom, Fiduciary Liability and sometimes-even Professional Liability comprised under one insurance program. Whether you purchase on a package basis or a la carte, if you have not looked into D & O Insurance before, now may be the right time.



# To Cover Or Not To Cover? - That Is The Question

*In our daily lives, most of us spend little time contemplating whether to purchase insurance coverage or, as they say in the insurance industry, “go bare.” Most of the decisions are made for us. Our mortgage company may require us to have homeowners insurance, our state and/or auto leasing company may require that our private passenger or commercial auto policy is in place prior to our taking to the open road, and our clients, especially those with risk managers, may require that we have a variety of coverage’s in place prior to doing business with us. However, there are numerous decisions left for us to contemplate. Buy long-term care insurance at age 40? “I feel healthy as a horse,” you say to yourself. “I’ll wait.”*

The problem with the decision making process is that, when the decision is up to us, we sometimes don’t think things through to their logical conclusion. Following are some considerations that should go into any insurance buying decision:

1. Risk Aversion - “How risk averse am I?” If I am very risk averse, I will be inclined to purchase just about any coverage available, with little regard to pricing, and I will probably buy the highest limits of coverage with the lowest deductible available. Alternatively, if I am not risk averse, i.e., I am comfortable “underwriting” my own risk, I may be inclined to eschew coverage and go bare. “How risk averse am I?” is a question that should be asked any time an insurance buying decision is made. The same question will be asked of you by a stockbroker or mutual fund adviser when deciding on investment decisions as required by law, but it is equally relevant in the insurance buying process.
2. Financial Wherewithal - “How much insurance can I afford to buy?” Often the decision is one of putting food on the table versus buying insurance, or at least that is what appears to be the case. Viewed in its true light, buying the right kind of insurance might be tantamount to insuring the continuing ability to put food on the table. This may become more obvious when the costs and benefits are broken down and analyzed carefully.

3. A cost/benefit analysis is an important step in any insurance buying decision. What is the nature of the exposure I am considering insurance for? Is it a catastrophic exposure like death, disablement or liability for injury to another? Is it coverage for an appliance repair, which may be costly, but will not likely break the bank? (Note: Warranties are not considered insurance products in all states.) The benefits may not outweigh the costs when considering the likelihood of an appliance breakdown, especially when factoring in the manufacturer’s warranty. Try to obtain statistical information regarding the likelihood of a breakdown after the warranty period is over. You may be surprised to find out how many appliance breakdowns occur during the manufacturer’s warranty period versus the extended warranty period.
4. Last but not least, an extremely important question that must be asked is “What am I insuring?” or “What am I protecting?” In the warranty decisions discussed above, it may be a \$139 DVD player or a \$20,000 automobile. In the long-term care scenario it may be your financial assets that you are protecting, though the benefit of choice of care and other quality of life issues may come into play in the decision as well. If you have little or no financial assets, i.e., you don’t own a home or have a nest egg of any significant size to protect, long-term care may not be the right choice for you at this particular time. The trade off in buying now versus waiting, however, certainly warrants careful consideration. For example, you may be building your nest egg and when it is of significant enough size, you may decide the time is right for long-term care insurance, but you may regret not having purchased the coverage when it was much more affordable.

So the stakes are obviously different depending on the type of coverage you are purchasing. You need to consider the right limits and deductibles for your risk aversion profile and give careful thought to what the product is, what your expectations are, and what alternatives are out there. You may decide that less or no coverage is appropriate for you, but the important thing is that you fully understand and give careful consideration to the benefits of coverage...and the risks of going bare.



# Keeping Up With the Jones and the Longshore and Harbor Workers' Compensation Act

Navigating the winding straits of various state workers compensation systems can be difficult to do for companies traversing state lines, but what if the company employs people at sea? If your business employs dockworkers or seamen of any sort, there are two acts you should be aware of.

The Jones Act (1920): - The Jones Act is a set of cabotage, or "admiralty" laws. Cabotage defines who has the right to engage in air, rail, truck or waterborne transportation in a country and its coastal waters. The Jones Act focuses on the latter.

Modeled in part after the Federal Employers Liability Act, which provides benefits to rail workers, the Jones Act governs the liability of vessel operators and marine employers for the work-related injury or death of an employee. The Jones act provides heightened legal protections to seamen because of their exposure to the perils of the sea but does not define the term "seamen." Federal court decisions have narrowed the definition to exclude land-based workers, though. Workers on offshore oil rigs, ships, barges, riverboat casinos, tug boats, shrimp boats, fishing boats, trawlers, tankers, crew boats, ferries and water taxis are among those who are eligible for Jones Act relief if injured.

The Longshore and Harbor Workers' Compensation Act (1927), a companion of sorts to the Jones Act, provides scheduled pay for injury or death, to a broad range of land-based maritime workers, excluding those covered under The Jones Act. Usually,

employees who load or unload vessels, build or repair ships, and stevedores are among those eligible for LHWCA status. Unlike The Jones Act, which is not administered by a federal or state agency, The Department of Labor administers LHWCA.

Although differentiating among employees eligible for consideration under the two acts seems simple, much litigation has ensued over the years since the two acts came into being, because "the myriad circumstances in which men go upon the water confront courts not with discrete classes of maritime employees, but rather with a spectrum ranging from the blue-water seamen to the land-based longshoreman." *Brown v. ITT Rayonier, Inc.*, 497 F.2d 234, 236 (CA5 1974)

Broad P & I (Protection and Indemnity) policies, Maritime Employers Liability and Maritime Workers Compensation products are available to cover Jones Act or LHWCA liability. Some products combine coverage for state workers compensation acts and Jones Act or LHWCA exposures. There are also policies available for employers with no "known" Jones Act exposure.

Although coverage for the liability imposed by employers under these acts may be more expensive than state workers compensation coverage, there may be penalties for non-compliance. LHWCA, for example, imposes a fine of up to \$10,000 and/or imprisonment of up to a year. Talk to your agent to discuss your exposures and to see what options are available.

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