

STATE OF NEW JERSEY
DEPARTMENT OF BANKING AND INSURANCE

IN THE MATTER OF THE 2008 ANNUAL)	
PUBLIC HEARING REGARDING)	HEARING OFFICER'S
N.J.A.C. 11:1-34, THE SURPLUS LINES)	REPORT
EXPORTABLE LIST)	

The annual Exportable List Hearing was held on Wednesday, January 14, 2009 at the Department of Banking and Insurance (“Department”) in accordance with N.J.S.A. 17:22-6.43 and N.J.A.C. 11:1-34. N.J.S.A. 17:22-6.43 provides that the Commissioner of Banking and Insurance (“Commissioner”) may declare eligible for export any class or classes of insurance coverage or risk for which, after a hearing, he or she determines that there exists no reasonable or adequate market among authorized carriers in New Jersey. This list of such risks, lines, or classes of insurance is known as the Exportable List.

The purpose of this hearing is to receive testimony and public comment from interested parties that supports the addition or deletion of items on the current Exportable List. Upon review of the relevant information, the Department will decide which items, if any, should be added to the Exportable List, based upon a conclusion that there does not exist a reasonable or adequate market among authorized carriers in the State of New Jersey for those particular lines, risks or classes of insurance, and which items, if any, should be deleted from the list based upon a conclusion that such a market does exist for them in New Jersey.

Pending the outcome of the hearing and a determination by the Commissioner, the current Exportable List may remain in effect. If the Commissioner determines that any items on the Exportable List should be added or deleted, an amendment to N.J.A.C. 11:1-34.6 will be proposed and published in the New Jersey Register. If an amendment is proposed, it may

include more, all, some or none of the classes of insurance set forth on the current list. The Commissioner must be satisfied by the evidence and testimony presented that the best interests of New Jersey's policyholders will be served by the elimination, and/or the addition, of one or more classes or lines of insurance from the current list.

The Department notes that Edward A. Tafaro, Chief Executive Officer of Exceptional Risk Advisors, Jane Golden, Regional Director with ISO for Government Affairs and Dennis Pellegrino, who represented the New Jersey Surplus Lines Association, testified at the hearing. Mr. Pellegrino stated that the Association remains neutral on the items presented at the hearing. The Department was seeking testimony regarding the addition of "livestock gross margin policies" to the Exportable List. The Department has also received written comments from Mr. Tafaro, Daniel Burns and Kimberly A. Mrvica. The testimony and/or written comments that were received by the Department suggested that it amend the Exportable List to address the following items:

I. Addition of Excess Disability /Special Risk Personal Accident

Edward A. Tafaro submitted written comments prior to his testimony at the hearing. He is the Chief Executive Officer of Exceptional Risk Advisor in Mahwah, New Jersey, and a licensed surplus lines producer in New Jersey as well as in other states. He helps private and public organizations obtain high limit disability insurance for their key personnel. Mr. Tafaro also stated that they provide high limit disability solutions for the sports and entertainment industries as well as for medical professionals, among other clients.

He stated that the nature of disability insurance and personal accident products available from admitted, or licensed, insurers in New Jersey is materially different from what is available

from surplus lines markets. Admitted carriers with standard, filed products are often locked into a risk for a period of time that makes underwriting volatile occupations and high limit risks impossible. He believes that for these and other reasons, admitted insurers have been unable or unwilling to offer the high limit disability insurance his clients require. Surplus lines insurers frequently are the only source of reliable coverage for these risks. Mr. Tafaro stated that an ability to act quickly to service the needs of New Jersey citizens is frequently critical to the efficient function of the New Jersey insurance market. Speed many times is essential in surplus lines transactions if the insured is to avoid gaps in coverage and to avoid disruption of consumers' businesses and their daily activities. Mr. Tafaro contends that there are many instances where attempting to procure special risk disability and personal accident coverage through the admitted market is impracticable and inefficient. For example, a highly-paid executive may desire to take out key person disability insurance for a larger portion of his salary than is obtainable in the admitted market. The executive uses the services of a producer to try to place this type of insurance. The producer has attempted to place this type of insurance for other clients in the past and knows through experience that admitted carriers will only write this type of insurance up to a much smaller portion of the salary than the executive needs to cover. However, as a technical matter, the producer must still attempt to place this insurance in the admitted market and be declined before placing the insurance with a surplus lines insurer even though the producer knows, based upon his or her prior experience or field underwriting guidelines, that the effort will fail. The ability of the producer, pursuant to the Exportable List, to request an exemption from the Department's Life and Health Office for the export of individual disability insurance adds further unnecessary delay to the export of these unique and already difficult to place risks to the surplus lines market, though he appreciates the

Department's willingness to consider the additional procedure as an alternative to prohibiting export altogether. This process is likely to take a minimum of several weeks, potentially requiring the insured to go without coverage during that period.

Mr. Tafaro stated that the following real life examples reflect situations whereby New Jersey individual residents and corporations would have difficulty obtaining appropriate insurance protection, as no viable admitted market exists to cover such complex or high limit risks:

1. A famous musician sought to procure personal disability income insurance. Admitted carriers will not insure this occupational classification.

2. A pediatric neurosurgeon sought to insure his \$1,500,000 income against a loss due to a disability. Admitted carriers declined to issue or participate above \$20,000 per month, leaving a massive gap in the surgeon's financial plan, as only 16 percent of his income was protected in the event of a disability.

3. A Super Bowl winning NFL star sought personal disability income insurance to protect his future value. Due to the player's occupation, he was unable to procure personal disability income insurance through admitted carriers.

4. An investment management firm was in the process of securing a \$50 million line of credit. As a caveat to the line of credit, the lenders required the Chief Executive Officer and primary shareholder to secure \$25 million of key person life and disability protection, with the benefit assigned back to them. The life insurance was procured through admitted markets; however, no viable admitted market existed for the required disability protection.

5. A 37 year old dentist with young children was in need of personal disability income protection. Admitted insurers declined the dentist as he was an overweight, Type 1 Diabetic with elevated lipids and blood pressure.

6. A publically traded company acquired a privately held business. As a condition of closing the transaction, \$5 million of key person disability insurance was required on the Chief Executive Officer of the target company. Due to the size of the policy required and the fact that the Chief Executive Officer was 74 years of age, coverage was unavailable through admitted markets.

7. A professional sports franchise signed a player to a new four-year, \$30 million guaranteed contract. The player's contract was guaranteed due to death and disability upon execution of the agreement, interim death and disability protection was required while the life and disability underwriting process was underway, i.e., as contract frustration/failure to survive insurance. There was no admitted market for this insurance.

Mr. Tafaro believes that it is important for the Department to consider whether Special Risk Disability and Personal Accident Coverage should be added to the Exportable List based on common sense and economics. He stated that the products available from surplus lines insurers to protect these types of exposures typically pay a producer far less commission than would be paid to the producer by an admitted insurer for standard disability business, incenting producers to use an admitted channel whenever at all available. Further, the margins on this class of business are such that smaller risks are economically very difficult to insure in a cost effective manner. Therefore, Mr. Tafaro contends that the Department should not be concerned that the surplus lines markets would attempt to directly compete with business currently being written by

admitted insurers. A traditional non-cancellable and guaranteed renewable disability insurance policy cannot be underwritten effectively for certain occupations, and at certain policy limits.

According to Mr. Tafaro the current process that is in place in New Jersey is far too complex and cumbersome as applied to these risks, as experienced advisors understand that these risks fall outside the underwriting guidelines of traditional disability and accident insurers. Other states, including California and New York, have conducted due diligence on this class and have determined that viable admitted markets do not exist for these classes of business, and thus have allowed the export of such risks to the surplus lines market. New Jersey citizens and insurance advisors should have access to the same surplus lines products as residents of these other states. Mr. Tafaro feels strongly that Special Risk Disability and Personal Accident coverage should be added to the Exportable List.

Daniel Burns, the President of an Illinois based company called Pro Financial Services, also submitted written comments. Mr. Burns provided some background regarding his firm, stating they have been an American Correspondent and Managing General Underwriter on behalf of non-admitted carriers for twenty-nine years. They provide specialty risk disability insurance primarily to white-collar professionals, physicians/surgeons, and athletes; however, they have the capability to insure individuals and groups in all fields who are unable to obtain adequate disability coverage through admitted carriers in the United States. The admitted providers of disability coverage have risk selection criteria that limits the amount of coverage individuals are able to obtain, or, in instances such as professional athletes, prevents them from being able to obtain any disability coverage whatsoever through traditional means. The products that are available through non-admitted carriers are designed to provide the additional coverage that professionals with substantial earnings need, as well as provide coverage to those whose

occupations are deemed un-insurable by admitted carriers. The vehicles in place through non-admitted carriers are not designed to, nor do they have the necessary infrastructures in place to compete with admitted providers of disability coverage.

Mr. Burns stated that non-admitted specialty disability insurance providers are the market of last resort for individuals and insurance agents. The coverages they provide are short in duration given the high-frequency of disability in certain occupational fields or the large potential losses due to the high benefit amount for income earners generating \$300,000+ in annual income. While admitted carriers provide insurance which is guaranteed renewable and non-cancellable until the insured reaches age sixty-five, specialty risk disability policies are only guaranteed for as short a period as six months and never longer than 60 months. Mr. Burns stated when contacted by an insurance producer, they always instruct them to obtain as much disability coverage as possible through admitted carriers due to the superiority of the product and in almost every instance they have already done so.

Mr. Burns stated that while the current New Jersey statutes allow for an exemption to possibly be granted in the event that three declination letters are received from admitted carriers after they have reviewed a set of applications, it is not in the best interest of an insurance agent to have any of his clients "declined." This will be permanently noted in nationwide information databases by the declining carrier and could well impact the insured's ability to obtain coverage in the future. Furthermore, the insured could construe such occurrences to mean that he or she has to disclose the declines and the circumstances surrounding each one on every future insurance application where the question is asked regarding previously having been declined for coverage. Mr. Burns strongly believes that allowing specialty risk disability to be included on

the Exportable List is in the best interest of the state of New Jersey as well as all of its constituents.

Kimberly A. Mrvica stated in her written comments that she is confident that as a commercial matter there is no licensed market for this type of coverage and therefore any diligent search will fail. She recognizes that there may be some hesitancy at this time to allow free export to the surplus lines market without a diligent search. She also noted that they are also cognizant of the fact that requiring a diligent search before export of this coverage would bring New Jersey into line with the approach under the New York surplus lines law. In light of these considerations she offered as an alternative to the original request establishing an exception to the general prohibition against the export of health insurance for “Special Risk Disability and Personal Accident Coverage” by amending N.J.A.C. 11:1-34 as set forth below:

...

(b) With the exception of disability insurance as set forth in (b)1 below **and “Special risk Disability and Personal Accident coverage” as set forth in (b)3 below,** the following kinds of insurance, if sold by eligible surplus lines insurers, are specifically not eligible for export, since the Department has determined that they are procurable from authorized or admitted insurers after a diligent effort:

...

3. “Special Risk Disability and Personal Accident coverage” means any insured:

i. Who procures insurance for risk of financial loss caused by the cessation of earned income due to disability from sickness, ailment or bodily injury where the Commissioner has found that this class of underlying disability insurance is not available from an authorized insurer;

ii. Who procures insurance for risk of financial loss caused by a contractual requirement to pay an executive or other person essential to the insured's business operations who can no longer perform his or her duties due to disability from sickness, ailment or bodily injury where the Commissioner has found that this class of underlying disability insurance is not available from an authorized insurer;

iii. Who procures coverage for risk of accidental death in an amount equal to or exceeding \$1,000,000 in face amount only where no reasonable or adequate market exists among admitted insurers; or

iv. Who procures insurance for risk of financial loss caused by a contractual requirement to pay an executive or other person essential to the insured's business operations who can no longer perform his or her duties due to death. Such coverage, where no reasonable or adequate market exists among admitted insurers, must be purchased in an amount equal to or exceeding \$1,000,000 in face amount only, and must be short term in nature, specifically with a policy period not to exceed 24 months.

Based upon a review of the record and the testimony provided to the Department, it appears reasonable to amend the Exportable List N.J.A.C. 11:1-34.6(b) to include aspects of Special Risk Disability and Personal Accident coverage. The Department's amendment will limit this coverage to professional athletes, musicians, entertainers and executives essential to an insured's business operations. The amendment appears in the attached Exportable List.

II. Crime Insurance

Jane Golden requested that the Department add "crime insurance" to the exportable list. Ms. Golden stated that Surety and Fidelity are deregulated lines of insurance under the

Deregulation Act of 1982, and that those lines of insurance, including rate rule and forms for those lines of business, do not have to be filed with the Department. Ms. Golden contends that there is a problem because “crime insurance” coverage is intertwined with the fidelity coverage with the ISO Program; it puts an undue burden on the industry as well as the Department to review these programs that are intertwined with deregulated lines.

The commenter asserts that 90 percent of the premiums attributed to losses are with fidelity and the piece that they have combines fidelity and crime so it does not make sense, given that fidelity is a deregulated line of business, that the crime portion of the policy not be deregulated. Ms. Golden suggested that placing “crime insurance” on the exportable list will give the industry as well as the Department more opportunities to concentrate on more relevant issues, especially since 90 percent of the policies are in fidelity.

Ms. Golden also noted that fidelity is the biggest piece of the policy of the non-filed class (deregulated), so when you prepare programs you can’t take the fidelity piece of the program away from the crime and it’s very difficult.

Based upon a review of the record and the testimony provided, the Department does not believe that crime insurance should be added to the Exportable List. There was not sufficient evidence or testimony adduced to support a conclusion that there currently is not a reasonable or adequate market for crime insurance among authorized carriers in New Jersey.

III. Livestock Gross Margin Policies

The Department indicated in its hearing notice that it is considering adding livestock gross margin policies to the Exportable List and would like to receive testimony regarding the coverage at the hearing. LGM Dairy provides protection against the loss of gross margin

(market value of milk minus feed costs) on milk produced from dairy cows. The indemnity at the end of the 11-month insurance period is the difference between the gross margin guarantee and the actual gross margin (if positive). The policy uses future prices and state prices for corn and milk to determine expected and actual gross margins, and may be tailored to any size farming operation. The price the producer receives at the local market is not used in these calculations.

Dairy cattle producers in Arizona, Colorado, Connecticut, Delaware, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Vermont, West Virginia, Wisconsin, and Wyoming will be eligible for LGM Dairy insurance, which is a federally reinsured program.

The Department notes that other states have advised that the license authority they are using is either Crop or Property. New Jersey does not specifically have a license paragraph that would include insuring commodities. Currently crop coverage license in New Jersey falls under the property license paragraphs. Additionally, while the USDA considers this insurance for their specific purposes, it is unlike the standard policies that insure specific perils or occurrences.

The Department notes that in its public notice announcing the date and time of the Exportable List Hearing, the Department requested testimony regarding “Livestock Gross Margin Policies” and that no testimony was provided or comments received either supporting or opposing the addition of this item to the Exportable List. Nevertheless, based upon the information noted above, the Department recommends adding Livestock Gross Margin Policies to the Exportable List since currently there are only a limited number of companies that write

this coverage, which in this case does not appear to constitute a reasonable or adequate market for such policies.

Conclusion

Based on the Department's staff's review of the record, testimony and transcript of the public hearing, I recommend that the Exportable List found at N.J.A.C. 11:1-34 be amended in accordance with the attached Exportable List to include "Special Risk Disability and Personal Accident Coverage" and "Livestock Gross Margin Policies."

Date

DeWayne H. Tolbert
Hearing Officer

(Revisions shown with asterisks, *thus*)

The Exportable list is as follows:

1. Amusement Devices, Parks and Carnivals;
2. Animal Mortality;
3. Armored Cars;
4. Auto Racing and Race Tracks;
5. Day Care Center Liability;
6. Difference In Condition;
7. Environmental Impairment Liability Insurance;
8. Excess and Buffer Liability;
9. Excess Loss and Excess Aggregate for Self-Insurers; Public Liability and

Workers' Compensation;

10. Golf Driving Range;
11. Fine Arts Dealers;
12. First Loss and Excess of First Loss Insurance;
13. House Movers and Building Demolition;
14. Kidnapping, Ransom and Extortion Insurance;
15. Manufacturers and Contractors Liability for Floor Waxers, Building

Maintenance People, Window Washers and Exterminators;

16. "Large Risks" which means any insured:

- i. Which procures insurance for any property casualty risk by use of the services of either an employee who is a full-time insurance manager or buyer, or a regularly and continuously retained qualified insurance consultant; and

ii. Whose aggregate commercial premiums for insurance (excluding, Life, Health and Accident, Annuities and Workers' Compensation insurance) total at least \$500,000;

17. Motor vehicle coverage as follows:

i. Physical Damage Coverage for Limousines; and

ii. Physical Damage Coverage for Trucks, including trailers and trailer interchange (over 10,000 pounds) for Non-Fleet (one to five) risks, and commercial fleet (over five) risks irrespective of gross vehicle weight;

18. Mortgage Impairment;

19. Pony Rides/Riding Academies;

20. Physical Damage Coverage for Private Passenger and Commercial Vehicles with an original cost new of \$40,000 or above;

21. Product Liability Products or Products Recall Coverage;

22. Professional Liability insurance as follows:

i. Errors and Omissions; and

ii. Professional Liability except:

(1) Legal malpractice liability;

(2) Medical malpractice liability

(A) Hospitals Professional Liability

(B) Physicians and Surgeons Professional Liability

(C) Dentist Professional Liability

(D) Employees Professional Liability

(E) Nurses Professional Liability

- (F) Optometrists Professional Liability
- (G) Physiotherapists Professional Liability
- (H) Chiropodists Professional Liability

- 23. Short Term Events;
- 24. Skating Rinks (Roller and Ice) and Skate Board Parks;
- 25. Swim Clubs/Swim Pools;
- 26. Vacant and Unoccupied Building;
- 27. Warehouseman's Legal Liability;
- 28. Automobile Personal Injury Protection (PIP) coverage in excess of \$250,000;
- 29. Commercial auto liability for taxi cabs and limousines; (Eligible Surplus Lines insurer's certificate of eligibility must state that they are permitted to write this risk.)
- 30. Commercial auto liability for intermediate and long-haul trucking; (Eligible Surplus Lines insurer's certificate of eligibility must state that they are permitted to write this risk.)
- 31. Liquor Liability;
- 32. Employment Practices Liability;
- 33. ***Livestock Gross Margin Policies***; and
- 34. Gap Coverage for Private Passenger and Commercial Automobile.

(b) With the exception of disability insurance as set forth in (b)1 below, ***and Special Risk Disability and Personal Accident Coverage as set forth in (b)3 below***, the following kinds of insurance, if sold by eligible surplus lines insurers, are specifically not eligible for

export, since the Department has determined that they are procurable from authorized or admitted insurers after a diligent effort:

1. Health insurance, including specific excess or aggregate excess purchased by self-funded health benefit plans, as defined by N.J.S.A. 17B:17-4. Insurance producers may, however, request an exemption for the export of individual disability insurance. Such requests, and any exemptions granted on the basis of such requests, shall be subject to the following provisions:

i. If a licensed New Jersey insurance producer, after making a diligent effort to procure an individual disability policy with an authorized insurer, finds that the coverage is unavailable in the admitted market, he may request an exemption to export disability insurance;

ii. The request shall include copies of at least three applications to and declinations from authorized insurers, a description of the specific coverage sought and an explanation as to why the Department should permit the coverage to be exported;

iii. If granted, such an exemption shall enable the producer to place an individual disability policy with an eligible surplus lines insurer which has a New Jersey certificate of eligibility which includes accident and health;

iv. Requests that are not granted within 30 days of receipt by the Department shall be deemed disapproved; and

v. The request shall be submitted to:

Department of Banking and Insurance
Life and Health Office
Attention: Gale Simon, Assistant Commissioner
20 West State Street
P.O. Box 325
Trenton, NJ 08625-0325

2. Annuities including Funding Agreements or Guaranteed Investment Contracts (GIC's) as defined by N.J.S.A. 17B:17-5.

***3. "Special Risk Disability and Personal Accident Coverage" means any insured:**

i. Who procures insurance for risk of financial loss caused by the cessation of earned income due to disability from sickness, ailment or bodily injury pursuant to v. below;

ii. Who procures insurance for risk of financial loss caused by a contractual requirement to pay an executive or other person essential to the insured's business operations who can no longer perform his or her duties due to disability from sickness, ailment or bodily injury pursuant to v. below;

iii. Who procures coverage for risk of accidental death in an amount equal to or exceeding \$1,000,000 in face amount only and with a policy period not to exceed 24 months, where no reasonable or adequate market exists among admitted insurers;

iv. Who procures insurance for risk of financial loss caused by a contractual requirement to pay an executive or other person essential to the insured's business operations who can no longer perform his or her duties due to death. Such coverage, where no reasonable or adequate market exists among admitted insurers, must be purchased in an amount equal to or exceeding \$1,000,000 in face amount only; and

v. Where the Commissioner has found that the class of underlying disability insurance referenced in i. and ii above is not available from an authorized insurer. For the purpose of this subsection Special Risk Disability and Personal Accident

applies to professional athletes; professional musicians; entertainers; and executives essential to an insured's business operations.*

(c) Life insurance is specifically not eligible for export pursuant to N.J.S.A. 17:22-6.40 et seq.

(d) The Department shall annually publish a notice in the New Jersey Register, which lists Unauthorized Insurers that qualify as Eligible Surplus Lines Insurers in New Jersey.

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