

From the Chairman's Corner

by Lynn D. Goodwin, CPCU, CIC, ARM



■ **Lynn D. Goodwin, CPCU, CIC, ARM**, is assistant vice president at International Placement Services, Inc., where she is responsible for underwriting, marketing, and supervising the Commercial Special Risks Department. She is chairman of the CPCU Society's E/S/SL Section. She started her insurance career in 1977, and has broad knowledge of all lines of insurance, including international insurance. She has worked for several insurance companies in the underwriting and marketing areas; and in 1992 moved into the retail side of the insurance business, working for Johnson & Higgins (now known as Marsh), Lockton, and Willis. Prior to joining IPSI, she marketed and serviced national accounts. Goodwin obtained the CPCU designation in 1993, the CIC designation in 1994, and the ARM designation in 1995.

I remember the place and time when I volunteered to co-chair the E/S/SL Section Committee. It was Phoenix, AZ, in April 2005, during the CPCU Society's Leadership Summit. The week prior to our committee meeting, our section committee chairman resigned due to job description changes. The four committee

members present at the meeting—**James A. Roe, CPCU; Priscilla L. Carroll, CPCU; W. Wesley Carroll, CPCU**, and yours truly—made a decision right then and there to vote for a chairman immediately.

Jim was very clever, however. He put my name down on every piece of paper so it would be a unanimous decision—thanks, Jim! Anyway, it didn't have to come to casting our votes. We just talked it over among us and I agreed to tackle the challenge, but only if Jim co-chaired with me. He agreed.

Why am I telling you this story? I wanted to share with you what volunteering my services has meant to me thus far. It has been a wonderful experience, and I hope that more CPCUs (especially the more recent designees) will consider sharing their talent with the rest of the insurance professionals.

Before I forget, I want to thank my employers, **Richard Eichhorn, CPCU**, and **Michael Eichhorn, CPCU**, for allowing me the time and resources to volunteer and to give back to the insurance community. Richard is president & CEO, and Michael is executive vice president of International Placement Services Inc. (IPSI), a wholesale brokerage firm headquartered in St. Louis, MO. Besides co-chairing the E/S/SL Section Committee, I am also the current president of the CPCU Society's St. Louis Chapter. The Eichhorns truly believe in being more involved with the CPCU Society. Thank you, Dick and Mike!

Although the 2005–2006 year was a transition one for the E/S/SL Section, we are on the move again! We went through an entire year without issuing a newsletter, but that will not happen this year because we have added to the

committee a very enthusiastic newsletter editor: **Mark C. Brockmeier, CPCU, ARe**. I know Mark will do his best to produce four newsletters this year. And you can help by providing him with articles. This is your chance to show off your writing skills! His e-mail address is brockmeier@us.ibm.com.

Besides recruiting a new newsletter editor, we also have a new webmaster: **Matthew Magner, CPCU**. Matt is very excited about managing our web site, and has recently visited Malvern for training with Leslie Higgins, the CPCU Society's senior creative manager (Leslie is guardian angel to every section and chapter webmaster . . . they sing her praises loudly!) If you would like to share thoughts or material with Matt, his e-mail address is magner@chubb.com.

I'm very excited about our new committee members; in addition to Mark and Matt, **Lana Sue Parks, CPCU, CIC**, has joined the committee. I look forward to a very successful year . . . more to follow next issue! ■

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Federal Bill on Surplus Lines Insurance and Reinsurance

by Mark R. Goodman and Michael Trier

■ **Mark R. Goodman** and **Michael Trier** are partners at Lord Bissell & Brook LLP, with broad experience in representing brokers and agents as well as insurers and other financial institutions in regulatory, transactional, and corporate matters, including contingent commission investigations.

Editor's note: This article appeared in the Lord Bissell & Brook LLP October 2006 "Client Update" newsletter and is reprinted with permission. Any questions about this bill or the current status of state regulation of surplus lines insurance or of reinsurance may be directed to Mark Goodman (312) 443-0409 or Michael Trier (312) 443-1859; or by e-mail at MGoodman@lordbissell.com or MTrier@lordbissell.com.

A bill recently adopted by the U.S. House of Representatives attempts to address the frustration that brokers, insurers, and their customers have with certain states' regulation of surplus lines insurance and reinsurance. House Bill 5637, the "Non-Admitted and Reinsurance Reform Act of 2006," would not give authority to any federal agency to regulate surplus lines or reinsurance. Instead, in a somewhat unusual approach, the bill would specifically prohibit the multi-state taxation and regulation of surplus lines insurance and multi-state regulation of reinsurance, and instead allow only one state to regulate those transactions. This bill in essence plays referee among state laws by, for example, permitting only the home state of an insured to tax and regulate a surplus lines transaction.

House Bill 5637 was adopted by the House of Representatives on September 27, 2006. However, the legislation has not been introduced in the Senate, and there is little chance of it being

passed by Congress this year. What is perhaps most interesting about the bill is not so much its technical provisions or its passage by the House, as the fact that the bill was introduced at all. The introduction of this bill, along with other federal legislative initiatives dealing with insurance, is a strong message that the frustration with the states' inability to operate in a uniform fashion has reached a high level. The bill can be viewed as a rebuke of the current practices of some states, and is an attempt to force all states to do what they have not voluntarily been able to do—operate in a uniform fashion so as to facilitate the transaction of surplus lines insurance and reinsurance on an interstate basis.

Background

The bill consists of two titles, both of which take the same basic approach as that taken in provisions of a draft of the State Modernization and Regulatory Transparency Act ("SMART Act") that has been discussed in Washington. See Lord Bissell & Brook LLP's *Client Alert: Proposals for Federal Regulation of Insurance*, (April, 2004) available in the Newstand section of www.lordbissell.com. The approach of the SMART Act (which has not yet been introduced) would not be to impose an optional or mandatory federal government regulatory scheme to be enforced by a federal regulatory body. Instead, the SMART Act would attempt to preserve regulation of insurance by the states, but require state regulation to follow certain federal standards. House Bill 5637 takes this same approach.

This approach is in contrast to the proposed National Insurance Act of 2006, also called the optional federal charter bill, introduced in the U.S. Senate earlier this year. The optional federal charter bill would give brokers and insurers the option of being chartered and regulated by a federal regulatory body to be created as part of the Treasury Department, which federal regulatory

scheme would preempt state regulation. See Lord Bissell & Brook LLP's *Client Alert: Optional Federal Charter Bill—Proposed Alternative to State Insurance Regulation* (May 2006) available in the Newstand section of www.lordbissell.com.

Title I—Surplus Lines Insurance

The provisions of Title I, entitled "Non-Admitted Insurance," are in response to the problems that surplus lines brokers and surplus lines insurers, and their customers, have faced for many years as a result of multiple states attempting to tax and to regulate surplus lines transactions involving an insured that operates in or has exposures in multiple states. Many states require, or at least take the position that they require, brokers to allocate surplus lines tax among the states on a multi-state risk. In addition to being complicated and burdensome, these allocation schemes are not consistent, and therefore potentially impose multiple taxation on brokers. In addition, some states have taken the position that they require the surplus lines broker to be licensed in that state if any part of the risk is located in that state, even if neither the insured nor the broker have their principal places of business in that state and no part of the negotiations or communications regarding the insurance placement take place in that state. Brokers, insurers, and their customers find these burdensome and inconsistent state rules frustrating, and their frustration has been exacerbated by repeated unsuccessful attempts to get the states, through the NAIC, to agree on a uniform tax allocation scheme and a uniform regulatory scheme.

Taxation of Surplus Lines

Section 101(a) of the bill addresses these concerns by prohibiting any state other than the "home state" of an insured from taxing a surplus lines transaction. The "home state" of an insured is defined as its principal place of business (or the state of

residency if the insured is an individual). The bill defines “premium tax” as including any tax imposed on an insured who independently procures insurance, and thereby also prohibits any state other than the home state of the insured from attempting to tax a direct placement of insurance with an unauthorized insurer.

The bill, in Section 101(b), also permits states to enter into an interstate compact to allocate among the states the premium taxes paid to an insured’s home state, but does not specify an allocation formula. Interestingly, the bill does not adopt the rather complicated and cumbersome allocation schedule that is contained in an NAIC’s model regulation on allocation of surplus lines tax (which allocation schedule has been adopted by only three states). Presumably, if the states cannot agree on such an allocation scheme, then the home state of the insured would keep all of the premium tax. Given the inability of states in the past to agree on a specific allocation formula, which is part of the frustration giving rise to House Bill 5637, it remains to be seen if such a compact could be effectively implemented. Large commercial states that serve as the home state of many commercial insurance buyers would have very little incentive to agree to any kind of allocation scheme. Nevertheless, Section 101(b)(4) states that Congress “intends that each state adopt a nationwide or uniform procedure, such as an interstate compact, that provides for the reporting, payment, collection, and **allocation** of premium taxes for nonadmitted insurance consistent with this section.” (emphasis added). This statement of Congressional intent (which, based on applicable Constitutional principles, cannot **command** the states to adopt an allocation scheme) assumes that allocation of premium tax on multi-state risks is appropriate and can be readily done.

Regulation of Surplus Lines

Section 102(b) prohibits any state other than the home state of the insured from requiring licensing of the surplus lines broker in respect of surplus lines insurance for that insured. The bill would specifically pre-empt the laws of all states other than the home state of the insured from applying to a surplus lines insurance transaction. However, Section 102(d) saves from preemption any state law that restricts the placement of either workers compensation insurance or excess insurance for self-funded workers compensation plans with a nonadmitted insurer.

The bill would restrict even the home state of an insured from regulating surplus lines insurance in certain respects. Section 104 of the bill would prevent any state from imposing any qualification standard on a U.S. domiciled surplus lines insurer other than a \$15 million minimum capital and surplus, and therefore would remove from states any discretion to deny surplus lines eligibility to an insurer on the basis of the state’s analysis of the safety and soundness or of the management of a surplus lines insurer. This section provides that no state may (i) impose eligibility requirements for U.S. domiciled surplus lines insurers “except in conformance with Section 5A(2) and 5C(2)(a) of the Non-Admitted Insurance Model Act” promulgated by the NAIC, or (ii) prohibit a broker from placing surplus lines insurance with an alien insurer that has been qualified to be listed on the Quarterly Listing of Alien Insurers maintained by the NAIC’s International Insurance Division. Section 5A(2) of the NAIC Non-Admitted Insurance Model Act requires that the surplus line company be authorized by its domiciliary state to write the line of business it intends to write on a surplus lines basis. Section 5C(2)(a) of the NAIC Non-Admitted Insurance Model Act requires that the insurer have capital and surplus of at least \$15 million.

Section 103 of the bill would prohibit any state, beginning two years after enactment, from collecting any fees for licensing a nonresident broker unless that state participates in the NAIC national insurance producer database for the licensing of surplus lines brokers (or an equivalent uniform national database). By threatening state fee revenues, Section 103 is intended to push states to participate in the National Insurance Producer Registry (“NIPR”) implemented by the NAIC, thereby facilitating the multi-state licensing of producers.

Finally, Section 105 of the bill prohibits states (including the home state of the insured) from requiring that a broker representing an “exempt commercial purchaser” make a diligent search to obtain desired insurance from licensed insurers before seeking that insurance from a surplus lines company, as long as appropriate disclosure has been provided to and acknowledged in writing by the insured. The definition of an exempt commercial purchaser roughly follows the definitions in many existing state laws of “industrial insureds;” the definition of exempt commercial purchaser requires that the insured employ or retain a qualified risk manager, and that the insured meet certain minimum net worth, revenue, or annual premium thresholds. The bill contains a long list of alternatives for what educational, certification, or experience qualifications are needed to qualify as a “qualified risk manager.”

Title II—Reinsurance

The provisions of Title II, entitled “Credit for Reinsurance,” are in response to attempts by a few states to regulate reinsurance transactions—even where neither the ceding company nor the reinsurer is domiciled in that state—by (i) imposing requirements and conditions for recognizing financial statement

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credit for reinsurance; (ii) requiring or prohibiting certain contract provisions, or; (iii) requiring additional reporting by and financial information from reinsurers. These states are not following the traditional rule that most states have followed of deferring to the state of domicile of the ceding company on such questions.

Financial Statement Credit

Title II, prohibits any state, other than the state of a domicile of a ceding company, from determining whether or not the ceding company may take financial statement credit for ceded reinsurance. Section 201(a) provides that if a reinsurance transaction qualifies for credit for reinsurance under the rules of the state of domicile of the ceding company, and that state is an NAIC accredited state, then no other state may deny a ceding company credit for reinsurance. This approach in line with the traditional rule followed by most, but not all, state regulators of deferring to the credit for reinsurance rules of the state of domicile of the ceding company. The bill, as adopted by the House, reversed

the approach taken in an earlier version of the bill, which provided that no state may deny credit for reinsurance if the reinsurance transaction qualified for financial statement credit in the state of domicile of the reinsurer. That original approach would have been unworkable and could have substantially hampered states in regulating the solvency of their own domestic insurers.

In addition, Section 201(b) prevents any state other than the state of domicile of the ceding company from restricting or eliminating the ability to contractually require arbitration of disputes, or from dictating what choice of law provisions the contract should contain.

Regulation of Reinsurers

Section 202(a) of Title II provides that if a reinsurer is domiciled in a NAIC accredited state, or is domiciled in a state that "has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation," then that state of domicile is solely responsible for regulating the financial solvency of

the reinsurer. Section 202(b) provides that no state other than the state of domicile of a reinsurer may require the reinsurer to provide any financial information other than that which it files with its domiciliary state. This provision appears to prohibit the state of domicile of the ceding company from requiring such additional financial information if the reinsurer is domiciled in an accredited state (or a state that qualifies for accreditation), but would permit any state to request such information from, for example, alien reinsurers. For purposes of these sections the term "reinsurer" is defined in Section 203(4) as an insurer that (i) is principally engaged in the business of reinsurance; (ii) does not "conduct significant amounts of direct insurance as a percentage of its net premiums" and (iii) is not engaged on "an ongoing basis in the business of soliciting direct insurance." ■



Mark Your Calendar!

We hope you'll join us at the CPCU Society's 2007 Leadership Summit, which will be held April 17-21, 2007, at the Rosen Shingle Creek Resort & Golf Club in Orlando, FL.

Watch for details in early 2007!

April 17-21, 2007

Surplus Lines Stamping Office Statistics

by Phil Ballinger, CPCU

Every six months, the Surplus Lines Stamping Office of Texas (SLSOT) compiles information from the 15 U.S. stamping offices. This includes total premium and items (policies, endorsements, cancellations, etc.) processed by each office during the preceding period.

Through June 2006, the stamping offices processed more than \$11 billion in surplus lines premium, an increase of 9.1 percent over the first half of 2005. Most of that increase is attributable to Florida, which saw a jump of more than \$760 million (48 percent), indicative of the severe market disruptions in that state. Total items processed increased 3.5 percent, to 1.7 million. ■

State	2006 Rates		6 Mos. Premium (mill.)			6 Mos. Items		
	St. Fee	SL Tax	2006	2005	% Chg	2006	2005	% Chg
AZ	0.20%	3.00%	\$283.8	\$278.2	2.0%	30,788	25,894	18.9%
CA	0.175%	3.00%	\$2,876.8	\$2,755.2	4.4%	256,056	246,056	4.1%
CO	-----	3.00%	\$251.0	\$234.0	7.3%	25,140	25,432	-1.1%
FL	0.20%	5.00%	\$2,370.4	\$1,602.3	47.9%	634,045	552,065	14.8%
ID	0.50%	2.75%	\$43.9	\$38.5	14.0%	7,566	7,105	6.5%
IL	0.10%	3.50%	\$475.1	\$528.8	-10.2%	53,419	54,580	-2.1%
MS	0.25%	4.00%	\$164.8	\$139.1	18.5%	31,803	29,493	7.8%
MT	1.00%	2.75%	\$25.5	\$29.3	-13.0%	4,133	4,216	-2.0%
NV	0.50%	3.50%	\$261.2	\$191.2	36.6%	14,369	12,005	19.7%
NY	0.20%	3.60%	\$1,683.9	\$1,790.0	-5.9%	107,041	102,348	4.6%
OR	0.25%	2.00%	\$160.6	\$138.3	16.1%	17,860	17,580	1.6%
PA	\$15.00	3.00%	\$515.0	\$522.5	-1.4%	63,426	84,597	-25.0%
TX	0.10%	4.85%	\$1,579.1	\$1,523.8	3.6%	442,479	465,384	-4.9%
UT	0.25%	4.25%	\$81.2	\$70.7	14.9%	8,042	7,887	2.0%
WA	0.25%	2.00%	\$357.8	\$364.2	-1.8%	50,233	52,734	-4.7%
TOTAL			\$11,130.1	\$10,206.1	9.1%	1,746,400	1,687,376	3.5%

Items include certain non-money filings in IL, NV, and TX.

AZ—New stamping fee rate effective January 1, 2006.

CA—New stamping fee rate effective January 1, 2006.

CO—Stamping fee temporarily eliminated effective January 1, 2006.

FL—New stamping fee rate effective April 1, 2006. FL data includes \$245.8 million/5,965 policies in IP insurance.

ID—New stamping fee rate effective July 1, 2006.

NV—Fee subject to \$25 minimum per item; no fee on endorsements.

NY—Gross premium reported in NY. Certain additional fees apply for late filing, cancel, etc.

OR—Change to \$5 flat stamping fee effective October 1, 2006.

PA—Flat stamping fee of \$15 per original filing.

TX data for 2006 excludes \$382.2 million in "other state" & \$101.1 million in "tax exempt" premium.

WA—New stamping fee rate effective July 1, 2006.

Notes from Surplus Lines Task Force at NAIC Fall Meeting

The National Association of Insurance Commissioners (NAIC) met in St. Louis, Missouri from September 9–12 to consider a variety of important regulatory matters. We wanted to share with you an excerpt from an article written by **Eric Nordman, CPCU, CIE**, of the NAIC for a recent CPCU Society Regulatory & Legislative Section newsletter. If you'd like an electronic copy of that newsletter, please e-mail your request to jkelly@cpcusociety.org

Surplus Lines

The committee heard from its Surplus Lines Task Force informing that it received a report from the Surplus Lines Financial Analysis Working Group on the previous quarter's addition of insurers to the NAIC *Quarterly Listing of Alien Insurers*.

The task force also adopted a motion instructing the NAIC's International Insurers Department to adopt the UCAA biographical affidavit. The reason for considering this action is to establish a uniform format of the affidavit that is acceptable to all state insurance departments regardless of whether the insurer is admitted or alien. The task force heard a report from a group of interested parties regarding its progress on a proposal to form an interstate compact. The interested parties group proposes a compact as a solution to tax and regulatory issues presented by multi-state surplus lines placements. The interested parties group met in St. Louis on September 8, 2006, and working with regulators, will be trying to fashion an interstate compact that would establish

standards for multi-state surplus lines transactions and address the premium allocation and tax issues. ■

ASLI Conferment Held in Chicago

The conferment ceremony for the Associate in Surplus Lines (ASLI) program was held in Chicago, IL, on September 15, 2006. This ceremony was conducted as part of the National Association of Professional Surplus Lines Offices (NAPSLO) Annual Meeting.

The Insurance Institute of America (IIA) develops the ASLI course materials for surplus lines professionals with support from the Derek Hughes/NAPSLO Educational Foundation. Since its inception in 1996, there have been 1,060 individuals who have completed the ASLI program. Thirty-four of this year's class of 169 new ASLI designees were congratulated by **Joseph D.**

Timmons, CPCU, ASLI, president of the Foundation, and **Andrew S. Frazier, CPCU**, treasurer of the Foundation. Diplomas were presented to the designees by **Ann E. Myhr, CPCU, ASLI, ARM, AIM, AU**, IIA's director of curriculum for the ASLI program. This 2005–2006 ASLI class represents 29 states and Puerto Rico.

During the ceremony, the top four graduates in ASLI's 2006 class were also recognized and presented with cash awards and commemorative plaques. **Chad Raver, CPCU, ASLI**, underwriter, General Star, Stamford, CT, received the Distinguished Graduate Award. **Katherine E. Connolly, CPCU, ASLI, AIM, AAI**, executive account

manager, Lipscomb & Pitts Insurance LLC, Memphis, TN; **Kelly A. Hadiaris, ASLI**, underwriter, James River Insurance Company, Richmond, VA; **Robert P. Sandblom, CPCU, ASLI, ARM, ALCM, AMIM, ARC**, filings analyst, Scottsdale Insurance Company, Scottsdale, AZ, each received an Award for Academic Excellence.

The ASLI program consists of two required courses, two electives, and national examinations. The requirements for completing the ASLI program will be changed effective January 2007 as indicated in the table on the next page. ■

Reminder from the American Institutes: ASLI Program Requirements to Change in 2007

ASLI Completer Rules

Effective January 2007

ASLI Courses

ASLI 163—Surplus Lines Insurance Operations

ASLI 164—Surplus Lines Insurance Products

Electives

To earn the ASLI designation, students must successfully complete ASLI 163 and ASLI 164, plus any two of the listed electives.

CPCU 510	Foundations of Risk Management, Insurance, and Professionalism
CPCU 530	The Legal Environment of Insurance
CPCU 540	Business and Financial Analysis for Risk Management and Insurance Professionals
AIS 25	Delivering Insurance Services
AIC 33	The Claims Environment
AIC 34	Workers' Compensation and Managing Bodily Injury Claims
AIC 35	Property Loss Adjusting
AIC 36	Liability Claims Practices
ARM 54	Risk Assessment
ARM 55	Risk Control
ARM 56	Risk Financing
AU 65	Commercial Underwriting: Principles & Property
AU 66	Commercial Underwriting: Liability and Advanced Techniques
AAI 83	Agency Operations and Sales Management
APA 91	Principles of Premium Auditing
APA 92	Premium Auditing Applications
AIAF 111	Statutory Accounting for Property-Casualty Insurers
AIAF 112	Insurance Information Systems
AIAF 113	Insurance Company Finance*
AIT 132	Insurance Uses of Technology
AIT 134	The Strategic Management of Information
ARe 141	Principles of Reinsurance**
ARe 142	Reinsurance Practices**
ARe 144	Reinsurance Principles and Practices

* Will not be offered after 2006

** No longer offered

Special Program Information

Waiver for Registered Professional Liability Underwriter (RPLU) designation granted by the Professional Liability Underwriting Society will satisfy both electives.

2006–2007 E/S/SL Section Committee

Your E/S/SL Section leaders look forward to serving and growing the section membership. Please tell us how we can provide value to you!

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The Specialist

is published four times a year by and for the members of the Excess/Surplus/Specialty Lines Section of the CPCU Society.

<http://essl.cpcusociety.org>

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Statements of fact and opinion are the responsibility of the authors alone and do not imply an opinion on the part of officers, individual members, or staff of the CPCU Society.

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Printed on Recycled Paper



The Specialist

Volume 20

Number 1

ESSL

December 2006

CPCU Society
720 Providence Road
Malvern, PA 19355
www.cpcusociety.org

PRSR STD
U.S. POSTAGE
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BARTON & COONEY