

Lone Star Lines

Volume 4, Summer Issue 1998 ~ Surplus Lines Stamping Office of Texas

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Comptroller Insurance Company Audits

What'ya Gonna Do When They Come See You?

Auditors from the Texas Comptroller of Public Accounts are currently auditing approximately 400 insurers each year. Many of these are surplus lines insurers. These audits are a relatively new phenomenon, prompted by two factors. First is the transfer of insurance tax collections to the Comptroller from the Texas Department of Insurance in 1993. The Comptroller's Office is known for aggressive auditing and has auditors located throughout Texas and several other sites (e.g., New York City, Tulsa, Chicago, and Los Angeles). Secondly the Comptroller is intent on providing more complete oversight of all types of nonadmitted insurance taxes. (See *Business Insurance*, May 25, 1998, page 1 and June 1, 1998, page 8.)

Audits of surplus lines insurers appear to be based upon a policy discrepancy analysis over a 3-4 year period. The auditor obtains from the insurer a "dump" of all its Texas business, then compares it to a policy listing from the Stamping Office. This is a run of all policies reported to SLSOT by surplus lines agents for that insurer. (This information is available from the Stamping Office to any Texas State agency, by law.) The insurer is asked to "explain" the taxes on any policies not reported through a licensed Texas surplus lines agent.

Understandably, surplus lines insurers ask upon what authority they can be audited, since they do not fall under state regulation. The Comptroller states the audit of the insurer is not based upon surplus lines taxes, which are the responsibility of the resident Texas surplus lines agent to pay. However, any Texas

premium not procured by a resident SL agent fails to meet the legal definition of surplus lines insurance (Art. 1.14-2, Texas Insurance Code) and would then be either independently procured (IP) insurance (Art. 1.14-1, Section 12) or unauthorized insurance (Art. 1.14-1, Sec. 11). The Comptroller claims jurisdiction to audit an unlicensed insurer for both. IP insurance taxes are paid by the insured or anyone designated by the insured. Unauthorized insurance taxes are payable by the insurer (with the insured liable in event of default by the insurer).

Each year the Stamping Office performs a cursory "Schedule T - SLSOT premiums processed" discrepancy analysis. The intent is to identify surplus lines policies that were not reported to the Stamping Office, for whatever cause. There are reasons discrepancies will always exist, including timing differences, differences in allocation methodologies, independently procured insurance, and the

Texas "orphan" law. (All premiums written, procured, or received in Texas are held to be Texas risks, unless those premiums on exposures located in other states are allocated and reported to those states as taxable.) Thus, the Stamping Office only evaluates discrepancies of significant volume. In 1997, these analyses resulted in the reporting to the Stamping Office of \$1.6 million in previously unreported surplus lines premium.

These evaluations appear to indicate that the vast majority of unreported premium is on business produced by out-of-state MGAs.

(continued as **Comptroller**, next page)



SLSOT: Population 27

The Stamping Office has been busy initiating its newest staff members to the team during the last few months. We are pleased to introduce...



Broeren

Leigh Ann Broeren. With over 20 years experience, Leigh Ann joins our staff as Administrative

Manager. She oversees accounting and payroll, employee benefits, and purchasing, as well as employment and human resource issues. **Claire**



Allman

Allman provides secretarial support to the managers and is also busy greeting visitors and directing calls to our office.



Norment

Cheyenne Norment has completed extensive training

on policy filing requirements and assumes her duties as the newest addition to the Data Entry Department as a Data Entry Clerk.



Jackson

Queeny Ornich (picture not available) prepares policies as a Records Prep Clerk in the Document Processing Department. **Tonja**



Mayberry

Jackson and **Gwen Mayberry** join the night crew as part-time Microfilm Prep Clerks for the Document Processing Department. ★

COMPTROLLER continued...

These MGAs sometimes either write business directly with Texas insureds or through a Texas local recording agent. Neither circumstance complies with Texas law regarding an eligible surplus lines insurer. The results of Comptroller audits seem to confirm this conclusion, as they find the vast majority of tax assessments arising from audits results not from unpaid independently procured insurance taxes, but from unauthorized insurance taxes. These occur primarily due to the actions of underwriting managers and MGAs outside Texas. It is possible taxes were not paid to any state for the majority of this type business.

Many insurers rely exclusively on controls by their MGAs to ensure business is written in compliance with the laws of the various states. This reliance may sometimes be misplaced. Some MGAs focus on premium dollars and either are not informed of or choose to disregard the restrictive Texas laws prohibiting direct writing by nonresident agents.

Recommendations

To minimize their exposure, insurers should:

- 1▶ Require the name and license number of the procuring Texas surplus lines agent on each piece of surplus lines business. Have this information readily accessible to provide to Texas auditors. The Comptroller indicates that if you can provide the SL license number of the resident procuring agent on a policy, the auditor will look to that agent to prove he is not liable for the taxes.
- 2▶ Review the controls used by MGAs to bind Texas business. Require underwriters to understand and comply with the restrictive nature of Texas surplus lines laws.

Observations:

- 1▶ The Comptroller's actions may be another incentive driving industry to lobby aggressively for a solution to multi-state tax allocation. This continues to be an ongoing concern at NAIC. The White Paper on Commercial Lines Regulatory Re-engineering clearly defines the problem, but does not offer a suggested solution.
- 2▶ The proper payment of surplus lines taxes can be especially difficult when the coverage is provided on a multi-state basis. This is in part due to the fact that many states that require the allocated payment of surplus lines taxes will not accept the payment of the tax on that portion of the multi-state risk resident or located in their state from a non-resident broker who is not licensed in that state. Yet, they do not typically license non-residents surplus lines brokers.
- 3▶ Another complicating factor from the industry's perspective is an approach taken by some states which requires the payment of the taxes on the entire premium to the state in which the broker is licensed. It is not possible to pay 100 percent of the tax to one state and then allocate to the remaining states without double taxation on the insured or broker.
- 4▶ The Comptroller requests that all questions relating to premium taxes be directed to Texas Comptroller of Public Accounts at 1(800)252-1387. ★



Stamping Office Workshops

The Stamping Office and the Comptroller's Office have teamed up to present this year's seminars "Introduction to Texas Surplus Lines Insurance". We have held this workshop twice over the last few months. The first workshop was



Agents chat during break

in the training room at the Stamping Office in April. Twenty-seven agents and other insurance office personnel attended, along with a dozen Stamping Office employees. The second workshop, presented in



Attendants sign in and pick up workshop materials

Focus on Educating New Texas Surplus Lines Agents

June at the Grapevine Convention Center in Grapevine for the Dallas/Ft. Worth area, was attended by sixty. The final session is being presented in Houston on August 13th, with seats filling up fast. The workshop originally planned for Tyler in October has been cancelled from the 1998 schedule due to minimal interest in that region. Although open to any interested party, the

sessions are geared toward newly licensed surplus lines agents and new employees of existing surplus lines agencies. These workshops are introductory level and emphasize the basics of surplus lines insurance. As of this printing, there are still a few seats available in Houston. Please call the Stamping Office, (512) 346-3274, ext. 23 for more information on how to register. ★



Batchman's Helpful Hints

Remember that reports on continuous until canceled policies use the tax rate and stamping fee rate effective on each year's anniversary date.

- Please provide the binder number on policies replacing binders if the policy number is different.
- Return tagged items on a NEW Transmittal & Verification Slip. Don't recycle your old Transmittal or return the tags without a Transmittal and Verification Slip if requested.
- When filling out your Transmittal Slip, please list the policy before endorsements, etc. if they are for that same policy. ★

A Day in the Life of the Insurance Industry

A company trying to continue its five-year perfect safety record showed its workers a film aimed at encouraging the use of safety goggles on the job. According to Industrial Machinery News, the film's depiction of gory industrial accidents was so graphic that twenty-five workers suffered minor injuries in their rush to leave the screening room. Thirteen others fainted, and one man required seven stitches after he cut his head falling off a chair while watching the film.



A bus carrying five passengers was hit by a car in St. Louis, but by the time police arrived on the scene, fourteen pedestrians had boarded the bus and had begun to complain of whiplash injuries and back pain. ★



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For Your Info

Comparison of SLSOT Premium Processed by Line of Business

Annual Statement Line of Business	Premium through 6/98	Premium through 6/97	Percent Change
1 Fire(incl. allied lines)	\$105,082,420	\$107,312,376	-2.08%
2 Allied lines	\$3,817,134	\$3,844,911	-.72%
3 Farmowners multiple peril	\$939,241	\$1,291,329	-27.27%
4 Homeowners multiple peril	\$19,572,847	\$19,530,009	.22%
5 Commercial multiple peril	\$10,150,392	\$13,829,463	-26.60%
6 Mortgage guaranty	\$0	\$0	0.00%
8 Ocean marine	\$5,784,730	\$10,161,170	-43.07%
9 Inland marine	\$9,183,170	\$6,178,371	48.63%
10 Financial guaranty	\$0	\$0	0.00%
11 Medical malpractice	\$4,596,551	\$11,635,337	-60.49%
12 Earthquake	\$537	(\$21,814)	102.46%
13 Group accident & health	\$35,882,291	\$31,963,007	12.26%
14 Credit A&H(group & indiv)	\$1,550	\$0	0.00%
15 All other A&H	\$24,695	\$1,019,421	-97.58%
16 Workers' compensation	\$0	\$0	0.00%
17 Other liability	\$232,248,141	\$248,889,976	-6.69%
18 Products liability	\$10,875,194	\$13,212,001	-17.69%
19.1 Priv.pass auto no fault	\$0	\$0	0.00%
19.2 Other privpass auto lia	\$43,045	\$20,891	106.04%
19.3 Comm. auto no fault PIP	\$0	\$0	0.00%
19.4 Other comm. auto liab	\$17,581,216	\$20,659,836	-14.90%
21.1 Priv.pass auto physical	\$507,803	\$592,020	-14.23%
21.2 Comm auto phys.damage	\$15,532,451	\$17,054,223	-8.92%
22 Aircraft (all perils)	\$1,231,354	\$4,194,722	-70.65%
23 Fidelity	\$945,791	\$658,934	43.53%
24 Surety	\$57,411	\$361,248	-84.11%
25 Glass	\$14,976	\$14,927	.33%
26 Burglary & theft	\$290,644	\$990,900	-70.67%
27 Boiler & machinery	\$507,111	\$296,050	71.29%
28 Credit	\$15,975,497	\$10,933,173	46.12%
31 Aggregate/other business	\$54,718	\$136,266	-59.84%
TOTAL	\$490,900,910	\$524,758,746	-6.45%

Note: Figures may not total due to rounding



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