



THE STATE OF FLORIDA

OFFICE OF INSURANCE REGULATION MARKET INVESTIGATIONS

MARKET CONDUCT FINAL EXAMINATION REPORT

OF

FLORIDA SURPLUS LINES SERVICE OFFICE

AS OF

August 23, 2012

TABLE OF CONTENTS

EXECUTIVE SUMMARY.....	1
PURPOSE AND SCOPE OF EXAMINATION	1
COMPANY OPERATIONS.....	1
FSLSO EXAMINATION COMPONENTS	2
EXAMINATION FINAL REPORT SUBMISSION	5

EXECUTIVE SUMMARY

On October 1, 1997, Section 626.921, Florida Statutes, became effective and provided for the creation of the Florida Surplus Service Lines Office, (FSLSO). The FSLSO is a statutorily mandated, nonprofit association of all Florida surplus lines agents.

The statutory responsibilities of the Service Office are to protect consumers seeking insurance in Florida, permit surplus lines insurance to be placed with approved surplus lines insurers, establish a self-regulating organization which will promote and permit access to surplus lines insurance in Florida, increase the number and types of insurance products available to consumers in Florida, provide a source of advice and counsel to consumers, surplus lines agents, insurers and government agencies relating to the operation of the surplus lines insurance market, and protect the revenues of the state of Florida.

PURPOSE AND SCOPE OF EXAMINATION

The purpose of this examination was to review compliance with Section 626.921, Florida Statutes and Rule 69O-207.001, Florida Administrative Code. The examination included a review of compliance with the plan of operation and a review of internal controls.

The Office of Insurance Regulation (Office), Market Investigations, conducted a target market conduct examination of FSLSO pursuant to Section 624.3161 and 626.921(6), Florida Statutes. The scope period of this examination was January 1, 2009 through June 30, 2012. The onsite examination began August 20, 2012 and ended on August 23, 2012.

In reviewing materials for this report, the examiner relied on records provided by the Company including various committee meeting minutes, internal procedures documents, manuals and educational materials.

COMPANY OPERATIONS

The Company is required to receive, record and review all surplus lines policies or documents, maintain records of information reported to the service office and prepare monthly reports for the Florida Department of Financial Services. Additional requirements include the preparation and delivery to each surplus lines agent monthly and quarterly reports of each agent's business and collection of service fees and remittance of premium receipt taxes to Florida Department of Financial Services.

More recently, as of July 2012, operations include additional fee income from performing clearinghouse duties. In 2010, the Nonadmitted and Reinsurance reform Act (NRRRA) was passed allowing only the home state to require premium tax payments for nonadmitted insurance unless there is a cooperative reciprocal agreement. Florida formally entered the Nonadmitted Insurance Multi-State Association (NIMA) in June 2011. By joining NIMA, a nonprofit corporation in the state of Florida, a reciprocal agreement exists and allows the participating states and territories to collect, allocate, distribute and report tax revenues. FSLSO is authorized to collect a service fee for the policies processed as a result of NIMA.

FSLSO EXAMINATION COMPONENTS

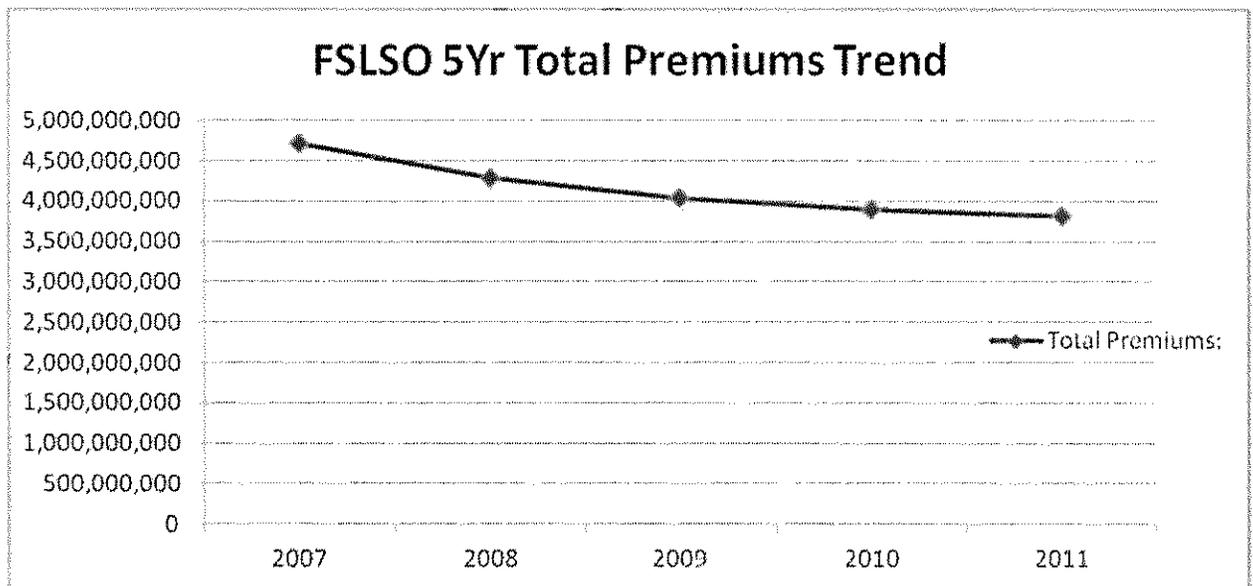
EXAMINATION OVERVIEW

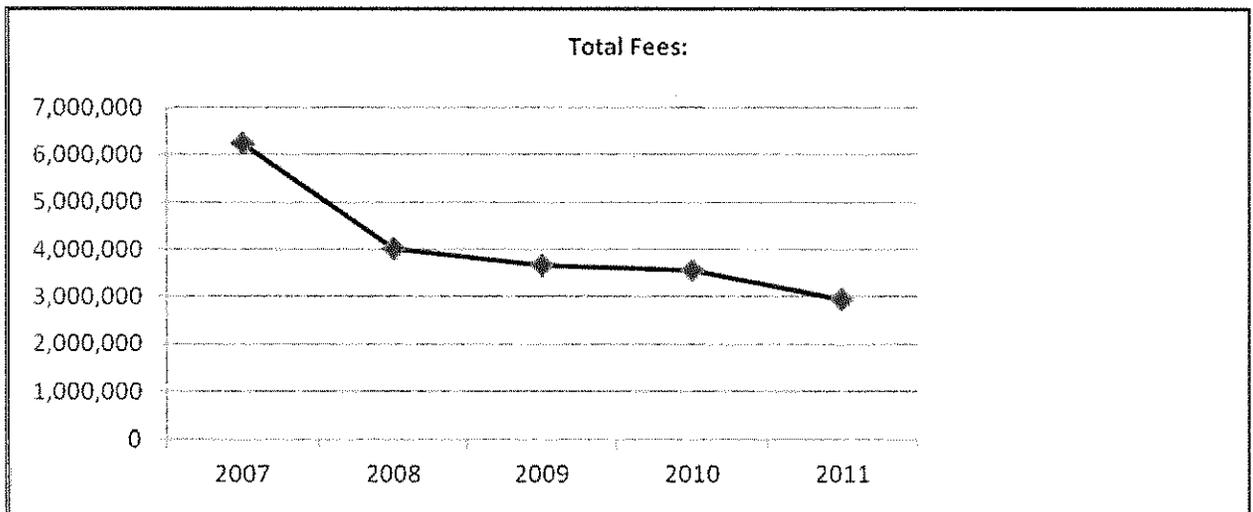
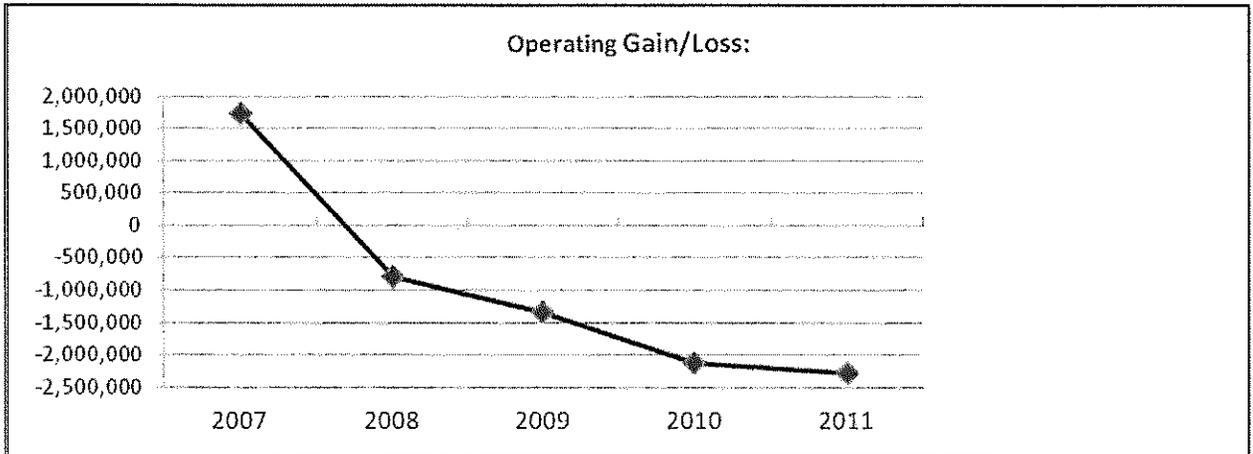
The examination of FSLSO was undertaken in order to determine compliance with Section 626.921, Florida Statutes. The review of documents included internal policies, procedures, operation plans, financial statements, board minutes and leases. In addition, the examination consisted of reviewing consumer complaints, the FSLSO website and interviewing employees.

The decline in the amount of premium reported to FSLSO is noteworthy. Factors directly related to this premium decrease include soft pricing in the surplus lines market which is indicative of increased capacity in the admitted market, coupled with the overall slowdown in the economy.

No violations were found during the course of the examination.

As shown on the following graph, annual premiums of approximately \$4.72 billion in 2007 have decreased at an average of 5% annually to approximately \$3.8 billion in 2011.





Executive and Operational Services:

Oversight is accomplished by a nine member board of governors, which includes eight members appointed by the Florida Department of Financial Services and the Insurance Consumer Advocate. Internal checks and balances by FLSO along with external audits and reporting are also undertaken. Pursuant to Section 626.921(5) (a), Florida Statutes, the Plan of Operation and amendments are submitted for approval by the Office of Insurance Regulation.

FLSO's \$1.6 million operating gain in 2007 was reduced to negative \$1 million in 2008, negative \$1.5 million in 2009, negative \$2.2 million in 2010 and negative \$2.3 million in 2011. In an effort to reduce unencumbered reserve funds held by FLSO as assets, the service fee rate was intentionally reduced as approved by the Board of Governors. As permitted by Section 626.921(3) (f), Florida Statutes, the FLSO service fee may not exceed 0.3%. From 1998 to 2003, the service fee rate was 0.3%; subsequently, the FLSO Board of Governors approved rate reductions in the amounts of 0.25% to 0.1%

over a nine-year time frame. Since 2007, the service fee rate has been 0.1%. The current market conditions, however, may result in an increase in the near future.

FSLSO owns the building that houses their staff of less than 25 employees. Additional space is available if needed for expansion as a result of NIMA. Currently a portion of the building is leased to a commercial tenant.

Agent and Insurer Services:

The examination included a review of documents and procedures to verify compliance with Section 626.921(1), Florida Statutes. Educational outreach, training classes, website resources and a proprietary electronic filing system are tools used to deliver advice, counsel and access in the arena of Agent and Insurer Services. Agent field audits are conducted both on site and as electronic desk audits by the FSLSO Compliance Review Program.

Invoicing of agents and independently procured coverage filers occurs on a quarterly basis and is inclusive of tax payments for the Florida Department of Financial Services, assessments payments for Citizens Property and Casualty Insurance Corporation and the Florida Hurricane Catastrophe Fund, and EMPA surcharge payments for the Florida Division of Emergency Management.

Financial and Information Services:

No concerns were noted during our review of policies and procedures for revenue collection. The funding of the FSLSO's budget is based on the board's decision to use unencumbered reserves for operational funding. We reviewed external audits for the scope period and found no unresolved issues or concerns.

There are procedures in place for database management and disaster recovery. The website and systems development areas have incorporated the creation of reporting and management systems used by agents and FSLSO.

On both the Financial and Information Services front, the impact of the developing NIMA participation is relevant. With regards to its participation with NIMA, FSLSO is postured to expand educational services, staff, and systems infrastructure as needed for the purposes of increased tax collections as dictated through an increase in the number of NIMA participating states. The current electronic filing platform and management systems may serve as an "in-demand" tool for the facilitation of surplus lines policy filing, tax collection and compliance oversight for other states wishing to join NIMA.

EXAMINATION FINAL REPORT SUBMISSION

The Office hereby issues this Final Report based on information from the examiner's draft report, additional research conducted by the Office, and additional information provided by the Company.