

# Diverging state rules fuel compliance challenges in surplus lines insurance

Florida led deregulation by eliminating the diligent effort rule in June.

By **Sanvi Bangalore**



A fast-changing landscape in E&S regulation is challenging compliance departments across carriers and wholesale brokers, as some states are growing less favorable for surplus lines markets while others deregulate.

After the pandemic, data calls – or directives from regulatory bodies towards companies to provide data – shot up, one executive told *Insurance Insider US*. While many of these calls ultimately might not have tangible consequences, it's not uncommon for carriers to deal with state fines or lines of questioning regarding eligibility.

The carrier executive said that in more stringent states like New York, investigation letters have routinely been sent to broker clients asking to justify why the business was placed in the surplus lines market.

A lack of sufficient delegations to defend your decision, “and you could be subject to enforcement action”, a legal insurance executive echoed.

The surplus lines industry is generally understood to offer carriers more freedom because they aren’t subject to rate and form filings like admitted carriers.

But as traditional admitted lines like homeowners and auto increasingly shift into the surplus lines market, states want their share of premium taxes, leading to disputes and complexities, one executive said.

The surplus lines marketplace [grew to over \\$130bn](#) in direct premiums in 2024, representing a growth rate of 12.5%. In terms of underwriting performance, E&S also continued to outperform the broader industry’s combined ratio by 5% in 2024.

Carriers and brokers in the E&S space are expectedly unexcited to see increased involvement by state regulators. Many industry executives said that regulations seem to lag several decades behind innovation like AI and digital platforms, making the compliance and enforcement process more disorganized.

Legal fees continue to be a challenge for brokers, especially for larger firms that have thousands of employees. And administering surplus lines coverage across such a big employee base is a big administrative burden and expensive in filing and legal fees, an executive said.

It is also growing increasingly common for state legislatures to pass laws regulating coverage for specific illnesses or coverages based on political pressure, an executive said.

States with more progressive leadership tend to penalize violations harshly and pursue investigations aggressively, another executive corroborated.

## **Re-evaluating the diligent search requirement**

The diligent effort rule mandates that before placing insurance through the surplus lines market, brokers must first canvass the admitted market to find coverage.

Originally, this requirement sought to protect the admitted market by ensuring surplus lines remained a last resort for hard-to-place risks, such as cyber insurance and coverage for mergers and acquisitions.

This expansion, coupled with the rise of InsurTechs offering on-demand, app-based binding, has made the diligent search process more complex.

Regulators' approaches are now diverging. Some states seem more eager to allow a flow of business into the surplus lines market, whereas others have a higher bar of "diligence". For example, Florida has taken a significant step toward deregulation by eliminating this requirement, making it the fifth state to do so.

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### Governor Signs House Bill 1549: Diligent Effort Requirement Eliminated

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House Bill 1549 has been signed into law, officially eliminating the "diligent effort" requirement for agents placing surplus lines insurance in Florida. The bill also adds additional language to the disclosure form that must be signed by the insured before placement with a surplus lines carrier. The disclosure form will now include the language, "surplus lines insurers' policy rates and forms are not approved by any Florida regulatory agency."



This removal is widely seen as groundbreaking and helps reduce friction for market participants, according to executives in the industry.

Conversely, New York maintains a rigorous approach that requires that brokers must perform a diligent search on a per-risk basis, meaning each individual insurance risk must have documented attempts to secure coverage from admitted insurers. This often requires obtaining a specific number of declinations or refusals from admitted carriers.

"A thorough, per-risk diligent search that can be impractical in high-volume, low-premium program settings," said Zach Lerner, chair of the insurance transactional and regulatory group at Troutman Pepper Locke LLP.

California meanwhile has intensified regulatory actions in response to wildfires in recent years. The state enforces moratoria on cancellations and non-renewals in

wildfire-affected zones and restricts insurers' ability to deny claims or collect premiums during disasters, according to an executive.

The state increasingly issues frequent data calls requiring both admitted and surplus lines insurers to report exposure, claims, and premium information especially after fires, an executive said.

These measures increase compliance burdens and reflect California's balancing act of expanding its market while protecting consumers in a high-risk environment.

Maine strictly enforces the principle that surplus lines insurance can only be used when no admitted market coverage is available. This means if an admitted insurer offers coverage, surplus lines placement is generally prohibited.

"Maine is, of all states, probably the most conservative ... requiring total admitted market, non-availability before surplus lines can be placed," a legal executive said.

Maine actively enforces general insurance laws against surplus lines carriers, fining them for non-compliance, which is not consistent throughout other states, the executive continued.

Diverging regulatory evolutions underscore the importance of staying informed and adaptable, Lerner advises.

"If you're not paying attention, you'll fall behind," he said. "The most compliant brokers and carriers routinely survey the market or use updates like ours to inform judgment calls on compliance."

## **Navigating emerging challenges**

As E&S regulation continues to evolve, carriers don't believe overall growth of the specialty industry is contingent on regulatory changes. However, carriers and brokers are still figuring out how to manage their talent around shifting needs.

"Our typical start-up client will lean heavily on us, and then, over time, hire a compliance officer to keep track of developments and licensing," Lerner said.

Lerner also pushes back against the common opinion that regulation enforcement is not robust. "The law of large numbers adds up," he advises. "One missed data call or requirement can lead to fines or penalties."

The best sources are state insurance department websites, consent orders, and NAIC bulletins to understand what regulators prioritize, another executive said of his company's efforts to keep on top of the latest changes.