Vermont Department of Banking Insurance, Securities & Health Care Administration
Insurance Division

Bulletin 134: Exclusion of Coverage for Punitive Damages in Policies Issued by Surplus Lines Carriers

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This Bulletin clarifies Department policy on whether surplus lines liability carriers must provide coverage for punitive as well as compensatory damages. The Department allows surplus lines carriers to exclude punitive damages from surplus lines policies because that encourages the development of the surplus lines insurance market and the coverage of risks that would not otherwise be covered.

The goal of Vermont's surplus lines law (Title 8 Chapter 138) is to provide a marketplace for insurance not available through admitted carriers. Prospective insureds that use the surplus market may present higher risks than are acceptable in the admitted market. Under Vermont law, surplus lines policies may account for this additional risk by higher premiums or coverage limitations or both. Mandating punitive damages coverage would only increase both risk and premium and might have negative effects on the availability of coverage in the surplus lines market: (1) prospective insureds who can't afford the higher premiums might go without insurance and (2) insurers who want to exclude punitive damages risk might leave the market, reducing the availability of coverage. In either case, not only would prospective insureds be deprived of any coverage, but those injured, the ultimate beneficiaries of coverage for compensatory damages, would be at risk of not being compensated for their injuries.

These considerations indicate that exclusions of coverage for punitive damages in the surplus lines market should be permitted. It should be carefully noted that the Department allows, but does not require, surplus lines liability policies to exclude punitive damages. This Department policy allows a prospective insured to bargain for coverage of punitive damages in the surplus lines market. Department policy merely allows an insurer to decline to sell that coverage.

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Commissioner