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Surplus Lines Insurance Simplification

The Proverbial Herding of Cats?

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As previously reported in a *Locke Lord QuickStudy* entitled "NRRA — Not a Surplus Lines Panacea," surplus lines insurance industry groups have been struggling for many years to simplify the state surplus lines insurance tax system, particularly for insurance placements made on multi-state risks. The industry's efforts were first primarily confined to seeking a solution from the NAIC. These efforts were unsuccessful for a number of reasons, including having to accommodate the differences in state laws, regulations, tax rates and procedures and the concern of some states that there would be a loss of tax and fee revenue. Industry next turned to Congress for a solution, and as early as 2003, bills were introduced to address industry's concerns.

In July 2010, Congress enacted the Nonadmitted and Reinsurance Reform Act (the "NRRA") into law as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank"). The NRRA is a federal legislative attempt to simplify compliance with state regulation of surplus lines placements and taxation.[2] Among the provisions of the NRAA is a mandate that nonadmitted insurance placements are subject only to taxation by the home state of the policyholder and the placement of nonadmitted insurance is subject to the statutory and regulatory requirements solely of the insured's home State.

Section 521 of Dodd-Frank provides that "[n]o State other than the home State of an insured may require any premium tax payment for nonadmitted insurance…" and that "[t]he States may enter into a compact or otherwise establish procedures to allocate among the States the premium taxes paid to an insured's home State…," in effect, preserving the states' authority over insurance regulation delegated by Congress in the McCarran-Ferguson Act.

Section 522 of Dodd-Frank further provides that "the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home State.." and that "[n]o State other than an insured's home State may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to such insured."

The NRRA was clearly intended to simplify multi-state placements of surplus lines insurance policies by eliminating regulation and taxation by more than one state. So far, however, the result has fallen far short of the intention. Section 521 did not mandate a compact or procedures to allocate premium taxes among states. The states have yet to agree upon a uniform regulatory response, and industry continues to struggle with how to get the states to agree among themselves.

At present, there exist three different approaches among regulators to compliance with the NRRA, but none has gained the approval of all states.

The Nonadmitted Insurance Multi-State Agreement (NIMA)

NIMA is the product of the NAIC's Surplus Lines Task Force and, in an effort to attract broad approval, is limited in scope to taxation. It purposely does not address other issues such as foreign insurer eligibility requirements and surplus lines policyholder notices.

NIMA, which has 10 states and Puerto Rico as members, contracted with the Florida Surplus Lines Service Office (FSLSO) to act as the clearinghouse for the collection and allocation of surplus lines premium tax payments for multi-state surplus lines policies. The FSLSO was to serve as the technology platform provider for fulfillment of all clearinghouse administrative duties. The clearinghouse was scheduled to begin receiving filings for policies issued or renewed on or after July 1, 2012. But, it has recently been reported that several states are considering withdrawing from NIMA, which could leave NIMA short of the minimum number of states to be econmically feasible.

More recently still, on May 22, 2012, the NIMA participating states (including those which were thinking of leaving NIMA) adopted a premium allocation method for distributing surplus lines premium taxes that streamlines the allocation and

distribution process of surplus lines premium taxes for surplus lines brokers and member states. If the latest agreements are effected, NIMA will launch its Surplus Lines Clearinghouse on July 1, 2012. The proposed allocation methodology (the so-called "Kentucky Proposal"), however, excludes the majority of casualty surplus lines premium from multi-state allocation. Therefore, the home state will continue to collect most surplus lines tax for casualty insurance unless a casualty policy is rated on a state or location-specific basis. Most of the other lines of insurance are allocated based on a specified formula.

The Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT)

An alternative approach to the state-based authority under the NRRA for surplus lines uniformity is SLIMPACT. Developed by an ad hoc group consisting of industry and regulators, SLIMPACT is a more ambitious plan which addresses not just the allocation of premium taxes among the states but also addresses foreign insurer eligibility requirements and surplus lines policyholder notices. SLIMPACT has gained the support of the National Council of Insurance Legislators ("NCOIL"). In part because of its ambitions, so far, SLIMPACT does not have enough states as members to become operational.

States Taxing 100 Percent of Home State Placements

Some of the larger and more populous states, including California, New Jersey, New York, Pennsylvania and Texas have no current plans for participating in tax sharing arrangements. Each of these states will tax 100 percent of the surplus lines premiums when it is the home state.

Some have said that neither NIMA nor SLIMPACT will succeed because of the lack of participation by these larger states and their realization that they would lose revenue by becoming a member of a surplus lines tax sharing agreement. In fact, because of the states' reactions, at least one large insurance trade association has suggested that the home state should tax and retain 100 percent of surplus lines premium taxes at the state's own tax rate, as opposed to the complications inherent in entering into shared allocation schemes.

Uniformity of Surplus Lines Insurer Eligibility

In addition to simplified tax allocation, the NRRA adopted provisions to streamline the eligibility process for surplus lines insurers. Section 524 of Dodd Frank allows states to enter into a compact to subject US surplus lines insurers to national standards for eligibility and requires that all states grant eligibility to all non-US insurers approved by the NAIC's International Insurance Department ("IID"). As the states have not yet entered into a compact, the only requirements that a state may impose are that (1) the insurer is authorized to write the types of insurance in its domiciliary jurisdiction and (2) that the insurer meets the capital and surplus requirements of the NAIC Nonadmitted Insurance Model Act. Non-US insurers, however, now have the benefit of eligibility from one source, the IID. Prior to the enactment of the NRRA, such insurers had to apply for eligibility in a number of states, although listing on the IID Quarterly List of Alien Insurers did give an insurer automatic eligibility in a number of other states. Some states, such as New York, required IID listing among many other requirements for eligibility.

Despite the relatively good track record of the IID, the IID has not been the sole authority over non-US surplus lines insurers in the past and has no procedures to coordinate with states to ensure that complaints and oversight by the states are considered. Furthermore, technical issues of the IID's regulatory and enforcement authority over non-US insurers will need to be addressed. The states and the NAIC recognized the IID's additional responsibility and in December 2011, through action at the NAIC Executive (EX) Committee and Plenary Session, approved the realignment of the Surplus Lines Financial Analysis Working Group under the Financial Condition (E) Committee from its previous position reporting to the Surplus Lines Task Force in order to better address these issues. In addition to this procedural change, the IID Quarterly Listing of Alien Insurers is now available free of charge. Other changes to the IID may occur to shore up its operations.

The NRRA was enacted to simplify surplus lines regulation - with a gentle push from the Federal Government. So far the states have not risen to the occasion. Although the states may yet regroup and rise above their several interests, current indications do not favor that prospect. Under the circumstances, the Congress may become the only alternative for establishing uniformity in an area of insurance regulation which has long been the purview of the states.

Endnotes
1 15 U.S.C. § 8202
2 The NRRA also contains provisions regarding reinsurance regulation, which is not discussed here.

For more information on the matters discussed in *Locke Lord's QuickStudy*, please contact the authors:

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