

Summary of the NRRA

Language from the Nonadmitted and Reinsurance Reform Act was included in the financial services reform legislation passed in June 2010. The new law is expected to significantly increase the level of efficiency in purchasing surplus lines insurance for all those involved in the surplus lines transaction--- from the insurance companies to the consumers. These bills would simplify the payment of surplus lines premium taxes, establish one state compliance on multi-state risks, streamline access to the surplus lines market for large commercial purchasers; and creates uniform surplus lines insurer eligibility standards.

Simplifying the Payment of Surplus Lines Premium Tax

The NRRA will simplify the surplus lines broker's payment of surplus lines premium taxes on multi-state risks by requiring that all premium tax due the states in a surplus lines transaction be paid to one state--- the insured's "home state."

The insureds home state is defined as the state of the principal place of business for a commercial insured or the state of residence for an individual insured. It is, then, up to the states to determine how and on what basis the premium taxes paid on these transactions will be allocated and distributed to the states. This eliminates the necessity of surplus lines broker paying taxes to each of the individual states where there is an exposure in a multi-state surplus lines transaction. This will save time and costs for the surplus lines broker in these transactions and provide certainty on tax payments.

It is the stated intent of Congress in the NRRA that there be established a nationwide or uniform system of reporting, payment, collection and allocation of surplus lines taxes among the states. The states may establish this uniform system by entering into an interstate compact or establishing other procedures for the allocation of the surplus lines premium tax. If the states fail to establish a nationwide/uniform procedure through an interstate compact or otherwise, the payment of the surplus lines tax becomes the exclusive province of the insured's home state. In either case, the NRRA would eliminate the uncertainty and confusion that has plagued the surplus lines broker for decades in determining how the premium is to be allocated for tax purposes, how and to what state the tax is to be reported, and when it is to be paid.

Under the NRRA the states will either establish uniform and consistent allocation and payment rules for surplus lines premium taxes under a compact or other agreement or the tax laws of the home state of the insured will apply to the entire transaction. One way or the other, the NRRA will create uniformity and certainty in the allocation and payment of surplus lines premium tax.

Establish One State Compliance on Multi-State Risks

The NRRA would eliminate the current confusion over which state, or states, have jurisdiction to regulate a multi-state surplus lines transaction by establishing a one-state compliance obligation for the surplus lines broker involved in such multi-state transactions. Since the enactment of Gramm-Leach-Bliley in 1999, non-resident surplus lines licenses have become available in virtually every state. The result of these universally available nonresident surplus lines licenses has been confusion in the marketplace as to which state laws apply in a multi-state surplus lines transaction.

If a policy covers risks in five different states, does the surplus lines broker have to?

- Be licensed in each state?
- Conduct five separate diligent searches under each of the five state's laws?
- Validate that the surplus lines insurer is eligible in each state?
- Provide five different policyholder notices or legends?

- Make five different affidavit or regulatory filings?
- Determine the regulatory requirements and what states have jurisdiction if the coverage is a casualty or a liability policy that covers the operations in each of the five states?
- Resolve the confusing question regarding what states the risk exposure reside in for a D & O policy, an E & O policy, or a products liability/completed operations policy?

These are not theoretical concerns. Surplus lines brokers face them every day and the states have been inconsistent as to their views on these issues.

The NRRA eliminates this confusion and potential multiple compliance obligations on the surplus lines broker by directing that the placement of surplus lines insurance “shall be subject to the statutory and regulatory requirements solely of the insured’s home State.” It further states that only the insured’s home state may require a surplus lines broker to be licensed to conduct a surplus lines transaction with the insured and pre-empts any other state laws that might apply to the placement, transaction or policy.

With the number of surplus lines transactions that involve multi-state exposures growing as the surplus lines market share expands and the risks entering the marketplace becoming bigger and more complex, the NRRA will make the placement of these multi-state risks easier, less treacherous and less costly for the surplus lines broker.

Streamline Access to the Surplus Lines Market for Large Commercial Purchasers.

The NRRA allows the surplus lines broker to place insurance on behalf of large, sophisticated commercial purchasers, as defined in the act, without having to satisfy a diligent search requirement. These commercial purchasers, known as “exempt commercial purchasers” must employ a “qualified risk manager” who has the education and training in insurance/risk management to properly represent the insured in this type of transaction and the insured (which can be a business entity or municipality) and in the previous year had in excess of \$100,000 in property and casualty insurance premium on a nationwide basis.

In addition, the insured must meet at least one additional criterion relating to:

- net worth (\$20,000,000),
- annual revenue (\$50,000,000),
- employees (500 full time employees or be an affiliate of a group that employees at least 1,000 employees)
- If the insured is a municipality, it must have a population in excess of 50,000.
- If the insured is non-profit organization or public entity, it must have an annual budget of at least \$30 million.

While the number of entities qualifying for this exemption may be limited, the surplus lines broker working on behalf of such “exempt commercial purchaser” can procure the insurance, even for a multi-state risk, without the impediment of a “diligent search.”

Create Uniform Surplus Lines Insurer Eligibility Standards Applicable for All States

The NRRA creates national eligibility standards for surplus lines carriers by prohibiting states from imposing any eligibility requirements other than the criteria established in Sections 5A(2) and 5C (2) (a) of the NAIC Nonadmitted Insurance Model Act (Model Act) for surplus lines insurers domiciled in a United States jurisdiction. Under the NRRA states cannot prevent surplus lines brokers from placing business with alien Nonadmitted insurers listed on the NAIC’s Quarterly Listing of Alien Nonadmitted Insurers.

In regard to surplus lines insurers domiciled in a U.S. Jurisdiction, the two sections of the NAIC model law would establish the greater of a state's minimum capitalization requirement for surplus lines insurer eligibility or \$15 million as the capitalization standard for surplus line insurer eligibility. The Model Act permits an individual state insurance commissioner to allow a company, having a lesser amount of capitalization, to be eligible under a specific set of circumstances, but in no case may the insurer have less than \$4.5 million in capitalization. The company must also be authorized by its state of domicile to write the type of insurance it seeks to write on a surplus lines basis in other jurisdictions.

Alien insurers listed on the NAIC Quarterly Listing of surplus lines insurers would be, in effect, eligible in every state as a surplus lines insurer. During the more than 40 years that the NAIC Quarterly Listing of Alien Insurers has been in existence, the list has had an impeccable record of containing only solid and solvent alien insurers.

The NRRA will eliminate the current confusion regarding surplus lines eligibility standards and create specific eligibility standards that will be used in every state. It would also provide certainty to surplus lines insurers as to their eligibility status at all times. The NRRA is expected to reduce, if not eliminate, the situation, often encountered by surplus lines brokers conducting multi-state transactions, where a company is eligible in one state but not in another.

Solvency evaluation and financial examination for U.S. domiciled carriers, under the NRRA would be conducted, as it is now, by the insurer's domiciliary state. This is no different than the way it is handled for admitted insurers in the current state based regulatory system. Nothing in the NRRA prevents state surplus lines stamping offices or state insurance departments from conducting and publishing their own financial analysis of surplus lines insurers.

Concerns over State Interpretation

Some states are suggesting that the section of NRRA which states "*No State other than the Home State of an insured may require any premium tax payment for nonadmitted insurance*" -- means that a "Home State" may "require" that the premium tax payment be allocated by the broker and the tax money be sent to the other states where exposures exists. In other words, the "Home State" of the insured "may require" payment of the tax to other states.

NAPSLO intends to work with the states over this misinterpretation as otherwise:

- This interpretation defeats the whole purpose of the bill.
- Under this interpretation the states could thus do to the NRRA what they did to Gramm-Leach-Bliley and the Liability Risk Retention Act-- impose regulations that undercut the purpose of the bill.

The purpose of NRRA Section is to require the broker to pay or remit all tax in a surplus lines transaction to the "Home State" and to no other state. If other states are to be paid, such payment is up to the states to handle the payments.

In addition, the full promise of the NRRA will not be realized until all surplus lines premium taxes (single state and multi-state tax) are paid on a "nationwide uniform" basis using the same "requirements, forms, and procedures." In other words, surplus lines taxes should be paid by the brokers in each and every state on the same day, using the same forms and through the application of the same or similar procedures. This is what Congress "intends" as explained in Sec 101(b)(4): *NATIONWIDE SYSTEM.—The Congress intends that each State adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provides for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance consistent with this section.*"