Surplus Lines

Pending State Legislation to Implement NRRA Is Fly in the Ointment

By Richard A. Brown

Pending state legislative proposals, such as California's AB 315, that would implement the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) are akin to the fly in the ointment.

The NRRA becomes effective on July 21, 2011, which also is the target effective date for the California Department of Insurance's legislative proposal. Under the NRRA, only the "insured's home state" may tax surplus lines premium and regulate surplus lines transactions. Enacted by Congress in 2010, the NRRA is an existing statute for which surplus lines brokers can prepare with appropriate planning. (See "NRRA Compliance Checklist: Prepare Now for Surplus Line Tax Changes and Enjoy Your Summer Vacation" and "NRRA Surplus Lines Requirements: The Devil is in the Details" on www.InsuranceJournal.com.)

As the NRRA's effective date approaches, four moving-target topics warrant particular attention: (1) the definition of "Home State," (2) surplus lines premium data reporting requirements, (3) surplus lines insurer eligibility requirements, and (4) disclosure requirements for placements on behalf of an "exempt commercial purchaser."

Home State Definition

Correct identification of the "home state" for a potential surplus lines placement is essential to ensure compliance with the home state's premium tax and other regulatory requirements. However, under AB 315 and other pending state legislation, the "home state" may not necessarily be the same state as the "home state" defined by the NRRA.

Although the NRRA generally defines the "home state" to be the state of the insured's "principal place of business" (or residence), the NRRA does not define the term "principal place of business."

To fill the definitional gap, AB 315 defines "principal place of business" in a way that may produce a different "home state" result than what one might think under the NRRA. (See "California Proposes To Disable Itself From Taxing 100% of Surplus Lines Premium" in *Insurance Journal*'s West March 1, 2011 issue).

Because California's principal place of business definition is copied from the NAIC's proposed "Nonadmitted Insurance Multistate Compliance Agreement," other states may choose to incorporate a similar definition in their own NRRA implementing legislation.

For planning purposes, surplus lines brokers with significant California business should familiarize themselves the definition of "home state" as it appears in § 1760.1(e) [AB 315, Section 9]. For other states, if pending legislation to implement the NRRA contains a definition of "principal place of business," that should be a red flag that the implementing legislation's definition of "home state" may produce different results from the NRRA's definition of "home state."

Tax Allocation Report

The NRRA provides 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 ...." Sec. 521(b)(1). To "facilitate payment of premium taxes among the States...." the states are authorized to require surplus lines brokers to file an annual Tax Allocation Report. Sec. 521(c).

The open question is how the states can reallocate their home state surplus lines premium tax collections among themselves without first agreeing to a uniform allocation methodology. To date, no state has become a party to a compact or other multi-state arrangement that would do so.

That said, AB 315 would amend CIC § 1774(a) to require surplus lines brokers to annually report premium allocation data concerning "single state risks" and "multi-state risks." Absent a compact that would allocate surplus lines premium taxes among the states, query whether the value of premium allocation data to the Golden State justifies the additional compliance costs that must be borne by surplus lines brokers.

How the § 1774(a) premium allocation data reporting requirements

continued on page 36

On The Web

For more information on the effects the NRRA will have on surplus lines brokers, visit www.InsuranceJournal.tv.

Surplus Lines

NRRA, continued from page 34

will fare in the legislative process remains to be seen. However, surplus lines brokers should anticipate that they may be required to continue allocating multistate surplus lines premium to accumulate premium allocation data on California "home state insureds," § 1760.1(f), for annual reporting purposes. A new form of annual statement to conform to § 1774(a)'s reporting requirements also will be needed.

Pending legislation in other states may also include new surplus lines premium allocation reporting requirements that may or may not be identical for every state. As AB 315 and its counterparts in other states wind their way through the legislative process, surplus lines brokers should be alert to the distinct possibility of new premium data reporting requirements.

Surplus Lines Insurer Eligibility

California's approach to implementing the NRRA's surplus lines insurer eligibility standards in AB 315 is explained in "How California Bill Implements Federal NRRA Surplus Lines Reform." (See *Insurance Journal*'s West March 8, 2011 issue.)

As a practical matter, surplus lines insurer eligibility for California risks should be business as usual for surplus lines brokers for the foreseeable future.

The NRRA "Uniform Standards for Surplus Lines Insurer Eligibility" are incorporated verbatim into a revised § 1765.1. The Golden State's present LESLI (List of Eligible Surplus Lines Insurers) procedures are replicated under a new § 1765.2 as the official "List of Approved Surplus Lines Insurers" (LASLI). LESLI-approved surplus lines insurers will be grandfathered for LASLI purposes as of July 21, 2011.

Other states can be expected to have their own interpretations of NRRA surplus lines insurer eligibility requirements.

Exempt Commercial Purchaser

The NRRA, Sec. 525, exempts surplus lines brokers from state diligent search requirements when the insured is an "exempt commercial purchaser" as defined in NRRA Sec. 527(5). Sec. 525 requires specific disclosures to the insurance buyer that are different from typical state law notice and disclosure requirements applicable to diligent search exemptions for an "industrial insured."

It is, of course, possible that some enterprising state regulator will integrate a state's industrial insured exemption with the NRRA commercial purchaser exemption.

Brown is an insurance regulatory attorney who represents surplus lines insurers, surplus lines brokers, and industry organizations in regulatory and other surplus lines matters. This is one of several articles he has authored about the NRRA. Articles are available on his Web site: www.InsuRegulatory.com. E-mail: RAB@InsuRegulatory.com.