

Department of Legislative Services
Maryland General Assembly
2011 Session

FISCAL AND POLICY NOTE

House Bill 911 (Delegate Rudolph)
Economic Matters

Insurance - Surplus Lines Insurance Multi-State Compliance Compact

This bill enters the State of Maryland into the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT).

The Department of Legislative Services (DLS) must notify the appropriate official of other states in the event of the bill's enactment. Subject to the enactment of a similar bill by another state, the bill takes effect July 1, 2011. A compacting state may withdraw at any time from the compact by enacting a statute specifically repealing the statute which enacted the compact.

Fiscal Summary

State Effect: Although the bill's requirement that only an insured's home state may license a surplus lines broker results in a decrease in special fund license fee revenues, this impact is also due to the federal law which takes effect three weeks after the bill. The amount cannot be reasonably estimated because it is not known how many nonresidents will not apply for or renew a license. The bill may have an impact on the amount of surplus lines premium tax general fund revenue collected. However, this amount also cannot be estimated because of numerous factors. Expenditures are not affected.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary:

SLIMPACT Commission

The bill establishes a joint public agency known as the SLIMPACT Commission. The commission will have the authority to adopt mandatory rules:

- establishing (1) exclusive home state authority regarding nonadmitted insurance of multi-state risks; (2) premium tax allocation and state rates of taxation; and (3) a clearinghouse for receipt and distribution of allocated premium tax and clearinghouse transaction data;
- for the purpose of financing, administering, operating, and enforcing compliance with the provisions of the bill and the commission's bylaws and rules; and
- establishing foreign insurer eligibility requirements and a concise and objective policyholder notice regarding the nature of a surplus lines placement.

The Compact Mandatory Rules

Nonadmitted Insurance of Multi-state Risks: Nonadmitted insurance of multi-state risks is exclusively subject to all of the regulatory compliance requirements of the home state regarding (1) the licensure of persons selling, soliciting, or negotiating surplus lines insurance; (2) insurer eligibility requirements or other approved nonadmitted insurer requirements; (3) diligent search; and (4) state transaction documentation and clearinghouse transaction data regarding the payment of premium tax as established by the compact.

Each surplus lines licensee is required to be licensed only in the home state of the insured for which surplus lines insurance was procured.

Premium Tax Allocation Formulas and State Rates of Taxation: The commission determines the allocation formulas for each type of nonadmitted insurance coverage and which allocation formulas are to be used by each participating state in acquiring premium tax. The allocation formulas will be established with input from surplus lines licensees and be based upon readily available data with simplicity and uniformity for the licensee as a material consideration.

Each participating state may charge its own rate of taxation on the premium allocated to the state provided that the state establishes one single rate of taxation applicable to all nonadmitted insurance transactions and no other tax or other charge or fee is permitted. Any change in the rate of taxation must be restricted to changes made prospectively on
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not less than 90 days advance notice to the commission. Each participating state must require premium tax payments either annually, semi-annually, or quarterly utilizing one or more of four specified dates.

A policy considered to be surplus lines insurance in the insured's home state is considered to be surplus lines insurance in all participating states and taxed as a surplus lines transaction in all states in which a portion of the risk is allocated. Each participating state must require a surplus lines licensee to pay every other participating state premium taxes on each multi-state risk through the clearinghouse. The amount of taxes is determined by the portion of risk in each participating state and the applicable uniform allocation formula adopted by the commission.

Clearinghouse for Transaction Data and Premium Tax Allocation: The commission must establish uniform clearinghouse transaction data reporting requirements for all information reported to the clearinghouse. The clearinghouse must then periodically report to participating states, specified surplus lines licensees, and insureds all premium taxes owed to each participating state, the premium tax due dates, and the required method to pay them.

A home state has the sole obligation to collect clearinghouse transaction data from surplus lines licensees and from insureds for independently procured insurance for reporting to the clearinghouse. Surplus lines licensees may not provide clearinghouse transaction data and state transaction documentation to any state agency other than the insurance department or tax officials of the home state.

Current Law/Background: According to the National Conference of State Legislatures (NCSL), surplus lines insurance is insurance that is not available from licensed insurers in the state. Because licensed insurers are unwilling to underwrite the risk, a consumer must go to an unauthorized insurer. According to the Maryland Insurance Administration (MIA), there are currently 135 approved surplus lines insurers and 1,463 surplus lines brokers operating with a certificate of qualification in the State of Maryland.

In Maryland, surplus lines insurance may only be procured from an unauthorized insurer in specified circumstances. A diligent search must first be made among the authorized insurers that are writing the particular kind of class of insurance in the State. A diligent search is completed if the risk is declined by three authorized insurers that are writing the particular kind and class of insurance in the State and by each insurer for which the insurance producer has been appointed that the insurance producer knows, or should know, is actually writing the particular kind and class of insurance on a broad basis. The insurance producer must include the declinations in an affidavit to the Commissioner at the time the surplus lines insurance is placed. A diligent search is not required for any

coverage on a list of eligible surplus lines coverages compiled by the Commissioner or if the diligent search is waived by a commercial insured in accordance with the process determined by the Commissioner.

Additionally, if a broker is used to procure the surplus lines insurance from an unauthorized insurer, the broker must be qualified. An applicant for a broker certificate of qualification must be qualified as an insurance producer for property and casualty insurance and be competent and trustworthy, as determined by the Commissioner.

A surplus lines broker may not place surplus lines insurance with an unauthorized insurer that the Commissioner (1) has not approved; (2) has determined to be insolvent or financially unsafe; or (3) has determined to have refused to pay just claims. A surplus lines broker may also place surplus lines insurance with an approved insurer by the Commissioner, including an alien insurer that has qualified with the nonadmitted insurer information office of the National Association of Insurance Commissioners (NAIC).

In order to be approved by the Commissioner, an insurer must annually file (1) a written request for approval as a surplus lines insurer for those surplus lines authorized by the Commissioner; (2) a certified copy of its annual statement showing a lines-item account of its surplus lines business written on risks located in the State; (3) a certificate of compliance issued by the insurance department of the insurer's state of domicile; and (4) a certificate evidencing a deposit issued by the official custodian of deposits of the insurer's state of domicile.

The State charges a 3% tax on all gross premiums charged for surplus lines insurance, less any returned premiums. Upon delivery of specified required materials, a surplus lines broker must charge the insured the amount of the tax in addition to the full amount of the gross premium charged by the insurer. If a surplus lines policy covers risks only partly in the State, the tax payable must be computed on the part of the premium that is properly allocable to the risks located in the State.

On or before March 15 and September 15 of each year, a surplus lines broker must file with the Commissioner a semiannual statement that reports on business subject to tax during the preceding half calendar year and pay to the Commissioner the total amount of tax imposed by State law. The Commissioner must verify the semiannual statement and that it contains specified required information.

The Nonadmitted and Reinsurance Reform Act

The U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, which included the Nonadmitted and Reinsurance Reform Act (NRRA). According to the National Association of Professional Surplus Lines Offices, NRRA

simplifies regulatory compliance obligations and premium tax payments for surplus lines brokers involved in multi-state transactions by allowing only the insured's home state to collect premium taxes and license a surplus lines broker. NRRA allows states to enter into a compact to share the premium taxes. NRRA defines "home state" as the insured's principal place of business or principal residence or, if 100% of the insured risk is located out of the state with the principal place of business or principal residence, the state with the greatest percentage of the insured's taxable premium for that insurance contract.

NRRA also allows surplus lines brokers to place insurance on behalf of commercial purchasers meeting specified requirements without having to first perform a diligent search requirement. The commercial purchasers must employ a "qualified risk manager" with the appropriate education and training to properly represent the insured and, in the previous year, had more than \$100,000 in property and casualty insurance premium on a nationwide basis. The commercial purchaser must also meet one specified additional criterion.

NRRA creates uniform national eligibility requirements to be used in every state. This may eliminate situations in which a surplus lines broker conducting multi-state transactions is eligible in one state but not another.

NRAA takes effect July 21, 2011. States must pass legislation prior to this date in order to avoid any conflicts with federal law. To do so, Maryland needs to amend some general insurance provisions relating to surplus lines insurance. These changes are not included in this bill; however, HB 959 of 2011 does make these changes.

SLIMPACT Participating States

The bill enters Maryland in SLIMPACT, a compact endorsed by the National Conference of Insurance Legislators. Because the bill creates a compact in which premium taxes are allocated among participating states, it is important to note how many states are considering similar legislation. According to NCSL, as of February 22, 2011, 26 states have introduced legislation to comply with NRAA. Fifteen of these states have legislation appearing to either enter into SLIMPACT or allow the equivalent of an Insurance Commissioner to enter into a compact, SLIMPACT or otherwise. If Maryland chooses to enter a compact, a state not in the compact could not require Maryland to distribute premium tax receipts to the state, even if the other state has a portion of the risks. Accordingly, the state would also not be required to distribute to Maryland.

State Fiscal Effect: MIA estimates that annual Maryland surplus lines premiums exceed \$400 million. This amount accounts for approximately 1.43% of the total amount in the United States. As noted above, the premium tax for surplus lines is 3%. Therefore, Maryland collects approximately \$12 million in premium tax on surplus lines insurance. This amount represents about 3% of total premium tax revenue in the State. Starting on

July 21, 2011, NRRA prohibits any state other than an insured's home state from collecting premium tax payments. This means that, unless a nationwide solution is reached by June 2011, nonadmitted premium tax on multi-state risks is collected only by the home state and may not be redistributed to other states.

By entering into a compact, Maryland may still collect surplus lines premium tax on property or risks located in the State even though the insured's home state is elsewhere. If Maryland chooses to not enter a compact, it keeps all surplus lines premium tax collected from insureds with Maryland as a home state, even if the insureds have risks located in other states. Because it is not known which states will enter into SLIMPACT, whether those states are the home states for insureds placing property and risks in Maryland, and the number of insureds with nonadmitted insurance of multi-state risks have Maryland as their home state, the bill's effect on Maryland's surplus lines premium tax collection is unknown.

The bill also complies with NRAA's provision that only an insured's home state may require a surplus lines broker to be licensed. MIA advises that it currently licenses 625 nonresident surplus lines brokers. MIA estimates that it is not possible to predict how many nonresidents will not apply for or renew a license; however, because the license population is relatively small and the license fee is \$200, any decline in special funds fee revenue should be minimal.

Additional Comments: HB 959 of 2011 makes changes to Maryland's surplus lines insurance law and facilitates the State's entry into SLIMPACT.

Additional Information

Prior Introductions: None.

Cross File: SB 694 (Senators Kelley and Middleton) - Finance.

Information Source(s): Maryland Insurance Administration, National Conference of Insurance Legislators, National Conference of State Legislatures, National Association of Surplus Lines Office, Comptroller's Office, Department of Legislative Services

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