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FEDERAL SURPLUS LINES REFORM IS ON THE ROCKS

By Robert "Skip" H. Myers, Jr.

The Nonadmitted and Reinsurance Reform Act of 2010 (the "NRRA") was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The purpose of the Act is to facilitate the reporting, payment and allocation of premium taxes among the states. Section 521 (b)(4) provides that "Congress intends that each State adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, and allocation of premium taxes for nonadmitted insurance"

While the Congressional intent was for state laws to be simple and uniform, the implementation of the NRRA by the states has been anything but. Two different models for the implementation of NRRA have been developed. First, the National Association for Insurance Commissioners ("NAIC") developed the Nonadmitted Insurance Multi-State Agreement ("NIMA"). NIMA is an agreement among the states that elect to join and provides for the collection and allocation of premium tax. Second, the National Conference for Insurance Legislators ("NCOIL") developed an interstate compact known as the Surplus Lines Insurance Multi-State Compliance Compact ("SLIMPACT"), which creates uniformity among the states for the laws applicable to the nonadmitted market as well as the collection and allocation of taxes.

The effective date of the NRRA was July 21, 2011. As of that date, the states (some would say predictably) have differed in various ways in the actions they have taken. Nine states have adopted legislation to adopt SLIMPACT while fifteen states have adopted legislation to enter NIMA; however, only three states had actually signed the agreement to enter NIMA. Five state legislatures have adjourned without taking any action. Legislation is pending in other states. Four states have enacted legislation which purportedly allows the states to tax and keep 100% of surplus lines premium but also allows the states to enter into an agreement or a compact after subsequent determination by the legislature or its designee.

This result is far from simple and uniform. NRRA creates "exclusive authority" in the "Home State" by mandating that "[n]o State other than the Home State of an insured may require any premium tax payment for

nonadmitted insurance." The "Home State" under the NRRA is the state in which an insured maintains its principal place of business or if 100% of the insured risk is located outside of its principal place of business, the state with the greatest percentage of an insured's taxable premium for that insurance contract. Section 527(6).

Therefore, Section 521(a) limits rather than enhances state authority by prohibiting non-Home States from requiring any premium tax payments for nonadmitted insurance. NRRA does not preempt existing state law except in regard to non-Home State laws and regulations that apply to nonadmitted insurance sold to a resident of the Home State. Section 522(c). However, NRRA encourages states to act in concert to collect such taxes: "The 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. . . ." Section 521(b)(1)(emphasis added).

The NRRA provisions and proposed models from the NAIC and NCOIL set up a series of circumstances where it is unclear what law prevails. This is due, at least in part, to the fact that only a minority of states have adopted any legal changes and even those are not uniform.

- If a non-Home State has not adopted either NIMA or SLIMPACT, is it restricted in its ability to collect premium tax on risks in its state where it is deemed that "transacting insurance" has occurred in that state? Under current state law, generally found in the Nonadmitted Insurer Act of various states, a state has the authority to tax a nonadmitted insurer when that insurer is "doing an insurance business" or "transacting insurance" in the state. If a nonadmitted insurer has satisfied these requirements, is a non-Home State prohibited from taxing its premiums? In other words, does the NRRA preempt Nonadmitted Insurer Acts?
- By what authority does a Home State collect premium tax on an insurance transaction conducted in a non-Home State if the non-Home State has not adopted either SLIMPACT or NIMA?

A few states have adopted laws that purportedly give the Home State the authority to collect tax on insurance "transacted" in another state. At least one state, Maryland, has included a provision which, in effect, authorizes the Home State to collect tax that "an unauthorized insurer effects. . . on a [Home State resident] . . . through negotiations or an application wholly or partly occurring or made in or from within *or outside* the State" MD House Bill 959 4-209(4) (emphasis added). In other words, the nonadmitted insurer's non-Home State risks are taxable even if the insurer is not "transacting insurance" for those risks in the Home State. This authority to collect tax at a surplus lines rate is not grounded in authority granted by federal law (although it

is encouraged by federal law). Rather, it is authority granted by the law of one state (the Home State) to collect tax on insurance transacted in another state or even offshore. The only legal nexus to the state is the residence of the insured.

The states' multifaceted approach to the NRRRA has not only created problems for multi-state insureds and insurance producers (particularly surplus lines brokers), but it also has pitted one state against the other. There are large states with substantial amounts of premium (e.g., Florida, New York, Texas and California) that stand to benefit by collecting all the tax due to the Home State and then keeping it. This certainly was not contemplated by NRRRA.

Finally, while Congress intended for the states to adopt a nationwide system of "uniform requirements, forms and procedures," the laws promulgated pursuant to the NRRRA and their enforcement are less uniform and more confusing. The U.S. Constitution allows Congress to preempt state law under the Supremacy Clause, but the Tenth Amendment prohibits the federal government from compelling states to adopt and enforce particular statutes. As a result, the NRRRA establishes uniformity as a goal, but it was limited to asserting only that the "states *may* enter into a compact or otherwise establish procedures to allocate among the states the premium taxes paid to the insureds Home State. . . ." Section 521(a)(1).

As a result, chaos has ensued. Now the states need to agree to a uniform system and implement it (presumably through an interstate compact) or there will be a movement for Congress to clean up the mess created by the states. □

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