

FEDERAL SURPLUS LINES REFORM CREATES UNCERTAINTY

The Coalition for Captive Insurance Clarity (CCIC) is pushing for clarification on the Nonadmitted and Reinsurance Reform Act of 2010 (the "NRRA")

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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 on surplus lines insurance 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 legislation was clearly intended to address only surplus lines insurance, the definition of "nonadmitted insurance" is so broad that a captive operating in a single state could arguably be considered included. Moreover, "independently procured insurance" is defined as insurance procured directly from a nonadmitted insurer. This has created an opportunity for states to assert that

they have the right to collect premium on captive insurance not placed on a surplus lines basis. It has also highlighted the opportunity for gathering more tax revenue through the enforcement of the state self-procurement laws.

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 by The National Association of Insurance Commissioners (NAIC) and National Conference of Insurance Legislators (NCOIL).

The effective date of the NRRA was July 21, 2011. As of that date the states have, somewhat predictably, differed in the actions they have taken.

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.

Therefore, Section 521(a) limits rather than enhances state authority by prohib-

iting non-home states from requiring any premium tax payments for nonadmitted insurance. NRRA does not pre-empt 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. 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 model laws from the NAIC and NCOIL set up a series of circumstances where it is unclear which law prevails. 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 state law empowering it to do so?

A few states have specifically adopted laws that purportedly give the home state the authority to collect tax on insurance "transacted" in another state. In other words, the nonadmitted insurer's non-home state risks are taxable even if the insurer is not "transacting insurance" for those risk 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 offshore. The only legal nexus to the state is the residence of the insured.

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

Finally, while Congress intended for the states to adopt a nationwide system of "uniform requirements, forms and procedures," the state laws promulgated pursuant to the NRRA and their enforcement are less uniform and more confusing. As a result, chaos has ensued. The Coalition for Captive Insurance Clarity (CCIC) has been formed in an effort to get Congress to clarify the law through a "technical correction". We can only hope. ☺