

BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	Solorio	AB 315

SUBJECT

Nonadmitted Insurance/Surplus Line Brokers

SUMMARY

This bill would forestall federal preemption on July 21, 2011, of state statutes pertaining to surplus line insurance taxation, eligibility, and broker licensure by the Nonadmitted and Reinsurance Reform Act (NRRA) of 2010 (Subtitle B of Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203, July 21, 2010)).

PURPOSE OF BILL

According to the author's office, the purpose of this bill is to make California law compatible with new federal law.

EFFECTIVE/OPERATIVE DATE

This is an urgency bill and would go into effect immediately; however, specified provisions in the bill would become operative on July 21, 2011.

ANALYSIS

FEDERAL/STATE LAW

Federal Mandate

The NRRA reforms and modernizes two important sectors of the commercial insurance marketplace, nonadmitted insurance (also known as 'surplus lines' insurance) and reinsurance. Specifically, the NRRA makes various changes to the business of surplus lines insurance including:

- Exclusive home state of the insured regulation of surplus lines insurance placements;
- Exclusive home state of the insured surplus lines broker license requirements;
- Exclusive home state of the insured premium tax collection unless a state compacts with other states on a method of allocation of taxes on multistate policy risks; and
- Preemption of many state specific eligibility requirements for surplus lines insurers.

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Thus, the NRRA creates a uniform system for nonadmitted insurance premium tax payments based upon the home state of the policyholder, encourages the states to develop a compact or other procedural mechanism for uniform tax allocation, and establishes regulatory deference for the home state of the insured. The NRRA adopts uniform eligibility requirements for nonadmitted insurers as developed and promulgated by the National Association of Insurance Commissioners (NAIC) in the Nonadmitted Insurance Model Act. The NRRA also allows direct access to the nonadmitted insurance markets for certain sophisticated commercial purchasers. The NRRA could be viewed as preempting state law that is incompatible with it.

A simplified example of a surplus lines multistate transaction is a business entity headquartered in one state with offices in other states seeking insurance coverage for all offices. Under the NRRA, the state in which the business is headquartered would be the home state and placement of the insurance business is subject only to the statutory and regulatory requirements of this state, as is the collection of the premium taxes. A state in which the business has another office must have the statutory authority to participate in a tax-sharing agreement or compact in order for it to receive its apportioned amount of the tax. Absent this authority, the tax monies go only to the home state of the insured.

Most provisions of the NRRA go into effect on July 21, 2011. However, provisions of a compact or agreement adopted on or before June 16, 2011, apply with respect to premiums for multistate transactions paid on or after July 21, 2010. A compact or agreement adopted after that date would apply with respect to premiums for multistate transactions paid on or after January 1, 2012.

Current California Law

A surplus lines insurer, also referred to as a nonadmitted insurer, is not licensed in California, but is licensed in another state or country. Under current state law, California licensed surplus line brokers may place coverage with a nonadmitted insurer if insurance for the risk is not available from a California-licensed insurer and other specified criteria are satisfied. Surplus lines premium tax imposed on the insured is collected by the Department of Insurance (CDI) from the broker placing the coverage, and the revenue is transferred to the Board of Equalization (BOE) for deposit into the state's General Fund.

In addition, policyholders who directly purchase or renew an insurance contract during the calendar quarter from an insurance company that is not authorized to transact business in California must pay a "nonadmitted insurance tax" (NIT). The tax is 3 percent on all premiums paid or to be paid to nonadmitted insurers on contracts covering risks located in California, and is imposed on any corporation, partnership, limited liability company, individual, bank, society, association, organization, governmental or quasi-governmental entity, joint-stock company, estate or trust, receiver, trustee, assignee, referee, or any other person acting in a fiduciary capacity.

Policyholders subject to the NIT must file Form 570, Nonadmitted Insurance Tax Return, with the Franchise Tax Board (FTB) on or before the first day of the third month following the close of any calendar quarter during which a nonadmitted insurance contract took effect or was renewed.

Not all contracts with nonadmitted companies are subject to the NIT. Nonadmitted insurance that is obtained through a California insurance broker is not taxable to the purchaser. Other exceptions are: (1) reinsurance of the liability of an admitted insurer; (2) insurance of ship-owner interests; (3) aircraft insurance; (4) insurance on interstate motor transit operations; and (5) life insurance.

Section 3.5 of Article III of the California Constitution prohibits an administrative agency, such as the CDI, BOE, or FTB, from declaring a statute invalid or unenforceable on the basis that federal law prohibits enforcement of that statute in the absence of an appellate court determination that enforcement of the statute is prohibited by federal law. Therefore, unless the statute is amended, these departments will be required to continue to enforce current law unless an appellate court rules otherwise.

THIS BILL

This bill would do the following:

- Authorize the collection of tax on 100 percent of California home state insured policies;
- Provide a common definition of home state insured, including principal place of business and principal residence;
- Conform surplus line eligibility standards to new federal preemption limitations;
- Provide for a permissive list of approved surplus line insurers that meet California's current, higher standards for eligibility;
- Conform surplus line broker licensing provisions to new federal preemption limitations; and
- Make other related changes.

LEGISLATIVE HISTORY

SB 625 (Johnston) (Stats. 1993, Ch. 1142) enacted the NIT program to be administered by FTB on non-admitted direct placement insurance contracts that take effect or are renewed on or after January 1, 1994.

PROGRAM BACKGROUND

The NIT program administered by FTB is not an income tax program. The program was enacted by SB 625 in the 1993/1994 fiscal year and the revenue to the CDI was estimated to be \$10-11 million annually at that time. The bill appropriated \$391,000 to cover FTB first year's administrative costs. At that time, according to the Surplus Line Brokers Association, 34 states levy a tax on non-admitted direct placement insurance. It was believed that only a few hundred insureds would be involved, and FTB would be able to administer the tax using a fairly simple manual processing method, using quarterly prepayments and an annual, reconciling return.

Currently the NIT program manually processes nearly 800 NIT returns per year and collects, on average, \$10 million in NIT per year. This is substantially more than the few hundred insureds originally estimated. There is no “information technology” (IT) system in place. Slightly less than 19 percent indicated risk located outside of California. Half of the 19 percent reported an address outside of California.

OTHER STATES’ INFORMATION

There is no single compact in place. The two competing compacts are Non-Admitted Insurance Multi-State Agreement (NIMA), which is supported by the National Association of Insurance Commissioners (NAIC), and Surplus Line Multi-State Compliance Compact Lite (SLIMPACT-Lite), which is supported by industry.

Based on information received by the CDI from the NAIC, the current status of state’s implementing the NIT is as follows:

- South Dakota has enacted a bill, HB 1030.
- About 15 states have NIMA-related legislation pending.
- Eight to ten states have introduced or will soon introduce SLIMPACT related bills.
- About 20 states are actively considering NIMA.
- About three or four states will seek to make changes to conform their statutes to the NIT, but they will not seek authority to join either NIMA or SLIMPACT.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

Recent federal legislation creates a uniform system for nonadmitted insurance premium tax payments and encourages states to create a compact or certain agreements for allocating taxes between states. California will continue to collect current NIT levels, but there is the possibility that California may collect more or less revenue.

FTB collects, on average, \$10 million in NIT annually. The revenue impact of this bill is dependent on the difference between:

- The additional taxes assessed on taxpayers with California home state insured policies that include out-of-state insurance, at 100 percent of total premiums, and
- The reduction of taxes assessed on policies that have a California insurance component but which would not be subject to tax because they do not meet the definition of a home state policy.

The net revenue impact is unknown but could result in gains or losses in the millions of dollars.

APPOINTMENTS

None.

SUPPORT/OPPOSITION

Support:

Department of Insurance (CDI) (Sponsor)
California Insurance Wholesalers Association (CIWA)
Insurance Brokers and Agents of the West (IBA West)
National Association of Professional Surplus Line Offices (NAPSLO)

Opposition:

None.

VOTES

Assembly Floor	05/19/11	Y: 78	N: 0
Senate Floor	07/01/11	Y: 33	N: 0

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