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TO THE HOUSE COMMITTEES ON
CONSUMER PROTECTON AND COMMERCE
AND JUDICIARY

TWENTY-SIXTH LEGISLATURE
Regular Session of 2011

Monday, February 7, 2011
2:00 p.m.

TESTIMONY ON HOUSE BILL NO. 1052 – RELATING TO INSURANCE.

TO THE HONORABLE ROBERT HERKES and GILBERT S.C. KEITH-AGARAN, CHAIRS, AND MEMBERS OF THE COMMITTEES:

My name is Gordon Ito, State Insurance Commissioner ("Commissioner"), testifying on behalf of the Department of Commerce and Consumer Affairs ("Department"). Thank you for hearing this bill. The Department strongly supports this Administration bill.

The purpose of this bill is to adopt the National Association of Insurance Commissioners' ("NAIC") recommendations relating to the states' implementation of the provisions of the federal Nonadmitted and Reinsurance Reform Act of 2010 ("NRRA") as they relate to the states' regulation and taxation of surplus lines insurance. NRRA's effective date is July 21, 2011. Surplus lines or nonadmitted insurance are insurance contracts that cover risks in states where the insurer is not an admitted or authorized insurance company.

The first of two significant changes is the regulation of surplus lines policies that cover risks in multiple states. Presently, each state with a covered risk may regulate the insured and the insurer. NRRA limits the regulation of the surplus lines to solely the "home state" of the policyholder. The proposed legislation provides for the adoption of NAIC recommended definitions of "home state" and conforms to the NRRA limitation.

The second significant change is to authorize the home state to collect premium taxes on multi-state surplus lines policies. The home state may collect taxes for all affected states and distribute to each state their share of the taxes.

Adoption of NAIC's recommendations are essential for the Insurance Division to participate in the multi-state effort to regulate companies and to collect and distribute the premium taxes. Presently, the Insurance Division collects and deposits into the General Fund $10,000,000 of surplus lines taxes. The proposed legislation is intended to authorize the Insurance Division to join with other states in arrangements that are being developed to ensure the continued receipt of the surplus lines taxes.

NAIC's recommendations were recently issued, but modifications and adjustments continue to be made. We ask for your consideration and approval of the attached proposed H.D. 1 that (1) changes the definition of state to include the Northern Mariana Islands; (2) substitutes "insured" for "subject resident," "surplus lines insurance" for "unauthorized insurance," and "unauthorized insurer" for "nonadmitted insurer;" (3) describes the reporting requirements to the Commissioner; and (4) defines the tax reporting and payment due dates for the transition period and beyond.

We thank this Committee for the opportunity to present testimony on this matter and ask for your favorable consideration.

proposed H.B. NO. 1052
H.D. 1

Report Title:

Insurance

Description:

Adopts amendments to the insurance code to comply with the federal Nonadmitted and Reinsurance Reform Act of 2010 relating to surplus lines insurance and participate in a multi-state cooperative to collect surplus lines premium taxes and fees and distribute to the individual states the taxes and fees they assessed.

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Richard M. Bouhan
Executive Director

DATE: February 4, 2011

TO: The Honorable Robert Herkes
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FROM: Steven P. Stephan, J.D., CPCU, ARe
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RE: HB1052/SB1279

The National Association of Professional Surplus Lines Offices (NAPSLO) represents surplus lines brokers and surplus lines insurance companies in all fifty states and the District of Columbia. NAPSLO would like to briefly comment about proposed legislation which amends the Hawaii surplus lines code. This proposal includes many of the provisions of the Nonadmitted and Reinsurance Reform Act (NRRA). We support this effort, as does the National Conference of Insurance Legislators, the Council of State Governments, and the National Conference of State Legislators. NAPSLO would like to thank you for your efforts to keep the Hawaii surplus lines code current.

First, we believe the following language misconstrues the NRRA:

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(b)      The commissioner shall collect the taxes and fees on
8  independently procured surplus lines insurance and from
surplus
9  lines licensees and disburse to the other states the funds
10 earned by each state, provided that the other state has a
11 reciprocal allocation and disbursement procedure for the
benefit
12 of this State.
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The tax revenue collected by Hawaii is Hawaii revenue and cannot be "earned by each state." Hawaii may elect to share some of its revenue with other states that reciprocate, but it is Hawaii tax revenue that is due on policyholders with a "home state" in Hawaii.

We are also writing to express our opposition to the language contained in HB1052/SB1279 granting the Insurance Commissioner the authority to participate in a multistate cooperative for taxes. The delegation of authority to the Commissioner was suggested to authorize the Commissioner to enter into an agreement known as the Nonadmitted Insurance Multistate Agreement or (NIMA). NAPLSO believes this proposal is a delegation of legislative authority to a state agency because it addresses tax issues that must be decided by the legislature. Any tax sharing agreement should be specifically set out in legislation and approved by the legislature. As a practical matter, this proposal is not adequate to apprise policyholders, brokers or legislators of how burdensome and expensive the NIMA proposal will be. A paper detailing our concerns about the NIMA proposal is attached.

NIMA would be an agreement between states that would result in a tax increase on some policyholders, would result Hawaii tax revenue being forwarded to another state, and would result in a surcharge on policyholders. All of these issues must be decided by the legislature after they are vetted through the legislative process. Decisions such as these cannot be delegated to an administrative agency.

If Hawaii is to impose additional taxes on policyholders and reporting requirements on brokers by entering an interstate tax agreement, the agreement should be transparently contained in legislation so the brokers, policyholders, and legislators know what is being proposed. We believe that for an interstate tax agreement to be effective it must be specifically spelled out in legislation and approved by the legislature. This proposal is inadequate legally and inadequate as a practical matter to notify the insurance community about the true burden and expense of the NIMA proposal.

We were advised by compact experts at the National Center for Interstate Compacts that it would not be legally adequate for a state to enter into an interstate agreement if the statute simply authorized a state agency, at its discretion to either enter or decide not to enter a tax allocation agreement. We were advised that the agreement language would need to be entered into the statute so the legislature has clearly decided whether or not to enter into a multi-state tax agreement. Another multi-state insurance agreement for life and health products, The Interstate Insurance Product Regulation Compact (IIPRC), has been adopted by 38 states and it was entered in its entirety into state statutes. It is not clear why something that is clearly a legislative issue such as taxes would be decided outside of the legislative process, while the IIPRC language was vetted through the legislative process.

The politics of tax allocation agreements are controversial. There are competing versions of surplus lines tax agreements. The National Conference of Insurance Legislators, the Council of State Governments and the National Conference of State Legislatures have all endorsed a version known as SLIMPACT. All three groups take the position that SLIMPACT should be included in its entirety in the state codes. We believe these groups have accurately assessed the necessity for including the terms of the multi-state tax allocation agreement in the state code.

We believe that this proposal imposes the tax rate of Hawaii upon those portions allocated to other states and support that view as further consistent with the intent of NRRA. However, we are not certain of that. It is possible that the proposed legislation combined with the use of the Clearinghouse would impose tax rates of other states upon Hawaii policyholders. We would oppose any provision taxing Hawaii policyholders at tax rates of other states. The NRRA would appear to envision the home state taxing its policyholders at its rates. If this issue is addressed at all, it should be addressed in connection with separate legislation authorizing a tax sharing agreement, if any is adopted.

We believe the non-tax NRRA provisions in this proposal are generally consistent with NRRA and should be included in the code even if the state is unable to adopt legislation implementing a tax allocation agreement. The definition of "home state," the modified eligibility language and the definition of an "exempt commercial purchaser" are examples of provisions that will be necessary regardless of whether the state adopts tax allocation legislation. We believe that this proposal needs language throughout more tightly focusing on Hawaii as the "home state" of the insured. We also see a need for the definition of qualified risk manager and the producer database language consistent with NRRA. We have attached a marked up copy of the bill with some suggestions.

With the exception of the clause authorizing the Commissioner to enter into an unspecified tax agreement, we support adding these additional provisions and the provisions of this proposal to the insurance code. The state also has an interest in seeing this proposal pass without delay because it will need to tax the gross premium when it is the home state of the insured. We would urge you to consider addressing tax allocation agreements in detail in separate legislation so the other reforms in this proposal may advance through the legislative process.

Thank you for the opportunity to comment. We have included a copy of the proposed legislation in revision mode with our suggestions outlined above.

SPS/clr

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Richard M. Bouhan
Executive Director

WHY NAPSLO OPPOSES THE NAIC'S NONADMITTED INSURANCE MULTI-STATE AGREEMENT (NIMA)

The National Association of Insurance Commissioners is advocating that the states' enact the Nonadmitted Insurance Multistate Agreement or NIMA. NIMA is an agreement between states created by an NAIC committee and designed to allocate surplus lines premium tax money among the states on multi-state surplus lines policies. NIMA was developed after the passage of the Nonadmitted and Reinsurance Reform Act (NRRA) which allowed, but did not require, the states to enter into an agreement to allocate multi-state tax revenue among the states.

NAPSLO opposes NIMA because it requires brokers to use intricate allocations formulas for casualty lines, which have not been required in practice or by existing state law. As a result, the NIMA allocation formulas will be burdensome for brokers and for policyholders who will be required to create and report intricate data for the first time. A few of the largest brokers have attempted to allocate all casualty lines, but it has proven to be too burdensome to use as a nationwide tax collection system. Moreover, the NIMA allocation requirements violate the spirit and letter of the NRRA which was enacted to implement a single-state tax remittance system.

Legislation has recently been introduced in many states including South Dakota, North Dakota, Oregon, and Arizona, that would allow the state to join the NIMA agreement by authorizing the insurance Commissioner to enter into an agreement for the allocation of surplus lines tax. NAPSLO opposes such legislation. If a state intends to impose additional taxes and reporting requirements on brokers by entering an interstate agreement, the legislation should be transparently set out in the statutes so the brokers, policyholders, and legislators know what is being proposed. The burdensome reporting, the additional taxes, and the policyholder surcharges should not be imposed through vague legislation that is inadequate to notify the insurance community about the true expense of the NIMA proposal.

NAPSLO believes the NIMA agreement and the legislation authorizing the Insurance Commissioner to enter into a tax allocation agreement with other states should be opposed for the following reasons:

1. **NIMA will create unnecessary and burdensome data reporting by brokers for the sole purpose of collecting taxes.**

   The NIMA system will require detailed data reporting of dozens of data elements for every policy issued for the sole purpose of remitting taxes on surplus lines policies with exposures in multiple states. The burden imposed is completely disproportionate to any legitimate regulatory need. One large broker reported that the software system developed to remit surplus lines taxes involves more that 25,000 reporting rules. The IRS never requires this level of burdensome detailed reporting for the sole purpose of remitting taxes. This burdensome process could have been replaced with a uniform annual tax return.

2. **NIMA requires novel allocation requirements for casualty lines**

NIMA requires allocation of dozens of casualty lines when the vast majority of states have not sought to impose this intricate reporting system in the past. Many casualty lines do not generate state-specific data in the normal course of business. Products liability, D&O, E&O, completed operations and many other lines are frequently not rated based upon state-specific rating factors. For many lines there is simply no data available to comply with the casualty allocation data requirements of the NIMA system. NIMA will require the policyholders to attempt to generate or, if it is unavailable, estimate data for the broker to report through detailed software, for the sole purpose of remitting taxes. Again, taxes could have been collected with a uniform tax return.

3. **State laws do not presently require allocation of casualty premium taxes.**

The vast majority of state laws require allocation of taxes on premium that is "properly allocable" to a state. Most surplus lines brokers construed the term "properly allocable" to mean that taxes on casualty premium should be allocated to the home state of the insured because that is where the exposure resides for a casualty risk. The corporate headquarters is intuitively where a liability exposure resides. There in no other more appropriate method of allocating casualty premium. Allocating casualty premium to the home state is more intuitive for most brokers than using other criteria such as payroll, square footage, number of employees, revenue or some other method.

Eleven states tax the gross premium on a policy so there is no allocation required at all in those states. A few states explicitly require allocation of casualty premium, but it is not possible to fairly enforce these requirements because the other states do not agree on a casualty allocation methodology. A nationwide allocation system cannot work unless it is uniformly implemented from state to state.

4. **NIMA fails to implement the efficient system or uniformity required by the Nonadmitted Reinsurance Reform Act (NRRA).**

The clear intent of the Nonadmitted and Reinsurance Reform Act (NRRA) was to create a streamlined tax system that involved a payment to the home state of the insured using uniform requirements, forms and procedures. NIMA not only fails to establish uniform requirements, forms and procedures, but instead continues, by contract, the burdensome system that Congress sought to eliminate with the NRRA.

NIMA will perpetuate unnecessary, bureaucratic data reporting, with dozens of data elements and hundreds of state-specific tax nuances for every multi-state policy issued. NIMA will result in the creation of a software system that will require the broker to input anywhere from dozens of data elements to hundreds of data elements depending upon the multi-state policy issued. The reason the NRRA was adopted was to replace this dysfunctional system involving a vast number of state-specific nuances with a single-state payment system that included uniform requirements, forms and procedures. NIMA circumvents the NRRA and continues with the existing system through a contract between Insurance Commissioners.

5. NIMA violates the NRRA requirement that "no state other than the home state . . . may require any premium tax payments for nonadmitted insurance."

The NRRA envisioned a single payment to the home state of the insured for a policy with multi-state exposures. The fact that the NRRA preempted any state other than the home state from using any "law, regulation, provision, or action" to collect its taxes, indicates that Congress intended the home state to use its tax rates. By adopting and signing NIMA a state is taking an "action" to collect its taxes in contravention of the NRRA. Instead of complying with the Congressional mandate, the NIMA proposal will require the collection of all surplus lines taxes, fees and assessments for every state where any portion of the exposure resides. Some states have several different fees and assessments tacked on to a surplus lines policy. The broker will be required to input data for all of these unique fees and assessments in direct contravention of the Congressional mandate that only the home state may require premium tax payments.

6. NIMA is not a transparent proposal

Legislation authorizing the Insurance Commissioner to enter into an agreement with other states fails to notify the insurance community that the NIMA proposal will impose numerous burdensome requirements and expenses on the broker and additional taxes and expenses on the insured. For many policyholders NIMA will result in a tax increase. NIMA will require policyholders with incidental exposures in the wind-exposed states to remit higher taxes to cover fees and assessments. The higher taxes will be necessary to fund state run facilities such as the hurricane catastrophe funds, and state-run insurance facilities. NIMA will also require Insurance Commissioners to impose a surcharge on policyholders to fund a clearinghouse. NIMA fails to indicate who will establish a clearinghouse, purchase computers, hire employees, set auditing standards, set accounting rules, purchase software, pay the expenses, rent office space, or open bank accounts. All of these issues should be more transparent because they impact the surcharge to be imposed upon policyholders. NIMA also fails to indicate how a contract signed by Commissioners can become law imposed upon insurance brokers or become the tax allocation law of the states. All of these issues should have been vetted through the legislative process because the NIMA agreement should have been introduced into legislation. Instead, some states have introduced legislation authorizing a Commissioner to enter into an agreement, which is inadequate to apprise the tax-paying brokers and policyholders of the burden and expense that will be imposed upon them by the NIMA system.

The legislation authorizing NIMA is not transparent and numerous objections to NIMA would be raised if NIMA were introduced as legislation. Legislation simply authorizing the Commissioner to enter into an agreement should be opposed because it not adequate to notify the insurance community that the intent is to implement the NIMA system and the added burden and expenses associated with it.