

## **FINAL BILL ANALYSIS**

**BILL #:** CS/CS/CS/SB 1816

**FINAL HOUSE FLOOR ACTION:**

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**SPONSOR:** Sen. Fasano (Rep. Hager)

**GOVERNOR'S ACTION:** Approved

**COMPANION BILLS:** CS/CS/HB 1227

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## **SUMMARY ANALYSIS**

CS/CS/CS/SB 1816 passed the House on May 4, 2011. The bill was approved by the Governor on May 26, 2011, chapter 2011-46, Laws of Florida, and took effect on May 26, 2011.

This bill changes the current collection method utilized in Florida to apply the surplus lines tax to the entire premium if the state is the home state of the insured as defined in Federal law. The tax rate is limited to the tax rate where an insured risk is located. The bill also authorizes the Department of Financial Services and the Office of Insurance Regulation to enter into cooperative reciprocal agreements with other states to collect and allocate nonadmitted insurance taxes for multistate risks pursuant to Federal law and to adopt rules. The reciprocal agreements must be implemented by the Florida Surplus Lines Service Office, which is authorized to collect the total tax imposed on a multi-state risk nonadmitted insurance premium. The Legislature may review any such agreement and may instruct the Chief Financial Officer to withdraw from an agreement if it determines that the agreement is not in the best interest of the state. The bill also requires a report to the President of the Senate and Speaker of the House of Representatives about the terms and conditions of the agreement.

The bill also provides that surplus lines agents and insureds that do not use agents to procure coverage will have 45 days after the end of the calendar quarter to file an affidavit describing transactions handled during that quarter and pay the required premium tax and fees.

On April 29, 2011, the Revenue Estimating Conference adopted an indeterminate positive estimate for both the multi-state agreement and the change to gross premium taxation. The impact of the change to gross premium taxation will be less than \$3.1 million annually.

**This document does not reflect the intent or official position of the bill sponsor or House of Representatives.**

## I. SUBSTANTIVE INFORMATION

### A. EFFECT OF CHANGES:

#### Background

#### Surplus Lines Insurance

Surplus lines insurance refers to a category of insurance for which there is no market available through standard insurance carriers in the admitted market (insurance companies licensed to transact insurance in Florida). There are three basic categories of surplus lines risks:

1. specialty risks that have unusual underwriting characteristics or underwriting characteristics that admitted insurers view as undesirable;
2. niche risks for which admitted carriers do not have a filed policy form or rate; and
3. capacity risks which are risks where an insured needs higher coverage limits than those that are available in the admitted market.<sup>1</sup>

Surplus lines insurers are not “authorized” insurers as defined in the Florida Insurance Code and thus do not obtain a certificate of authority from the Office of Insurance Regulation (OIR) to transact insurance in Florida.<sup>2</sup> Rather, surplus lines insurers are “unauthorized” or “nonadmitted” insurers, but are eligible to transact surplus lines insurance under the surplus lines law as “eligible surplus insurers.”<sup>3</sup> The OIR determines whether a surplus lines insurer is “eligible” based on statutory guidelines.<sup>4</sup>

Surplus lines insurance is placed by surplus lines insurance agents who are licensed and regulated by the Department of Financial Services (DFS). Licensing requires passing a written examination, having a set amount of experience or training in surplus lines, paying licensing and appointment fees, and posting a \$50,000 bond. The bond amount can be increased if DFS believes a greater bond is warranted due to the volume of surplus lines insurance transacted by the insurance agent.<sup>5</sup>

Before an insurance agent can place insurance in the surplus lines market he or she must make a diligent effort to procure the desired coverage from admitted insurers.<sup>6</sup> A diligent effort means seeking and being denied coverage from at least three authorized insurers in the admitted market unless the cost to replace the property insured is \$1 million or more. In that case, diligent effort is seeking and being denied coverage from at least one authorized insurer in the admitted market.<sup>7</sup>

Surplus lines insurance agents must keep specified records of the business it places in the surplus lines market for five years. The entity to which certain information must be provided as

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<sup>1</sup> Brief of the Office of Insurance Regulation in the case of CNL Hotels & Resorts, Inc. v. Twin City Fire Ins. Co., 2008 WL 3823898 (C.A. 11 (Fla.)) on file with the Insurance & Banking Subcommittee

<sup>2</sup> s. 624.09(1), F.S., defines “authorized” insurer.

<sup>3</sup> s. 624.09(2), F.S. defines “unauthorized” insurer, s. 626.914(2), F.S., defines “eligible surplus lines insurer,” and s. 626.918, F.S., provides eligibility for surplus lines insurers.

<sup>4</sup> s. 626.918(2), F.S.

<sup>5</sup> ss. 626.927-626.928, F.S.

<sup>6</sup> s. 626.916, F.S.

<sup>7</sup> s. 626.914, F.S.

well as the entity designated to facilitate compliance and provide assistance and information regarding the Florida surplus lines marketplace is the Florida Surplus Lines Service Office (Service Office). The Service Office is a statutorily mandated, not-for-profit association of all Florida surplus lines agents.<sup>8</sup>

The purposes of the Service Office are to protect consumers seeking insurance in this state; permit surplus lines insurance to be placed with approved surplus lines insurers; establish a self-regulating organization which will promote and permit orderly access to surplus lines insurance in this state; enhance the number and types of insurance products available to consumers in this state; provide a source of advice and counsel concerning the operation of the surplus lines insurance market for consumers, surplus lines agents, insurers and government agencies and protect the revenues of this state.<sup>9</sup>

The Service Office is required to receive, record, and review all surplus lines policies or documents, maintain records of the information reported to the OIR prepare monthly reports for the DFS. The Service Office is also required to prepare and deliver to each surplus lines agent monthly and quarterly reports of each surplus lines agent's business and collect a [service fee](#) of up to 0.3 percent of the total gross premium of each policy,<sup>10</sup> along with the surplus lines [premium receipts tax](#) of 5 percent of all gross premiums.<sup>11</sup> Service fees are used to fund the cost of operations of the Service Office. The premiums receipts tax is forwarded to DFS and deposited into the General Revenue Fund.

### **Recent Federal Legislation**

In 2010, the Nonadmitted and Reinsurance Reform Act (NRRA), which passed as a part of the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>12</sup> created new Federal law regarding premium taxation and regulation for surplus lines insurance. On July 21, 2011, a uniform system for taxation of surplus lines insurers goes into effect.

A key feature of the NRRA is the concept of “home state.” The Act provides that no state other than the home state of an insured may require any premium tax payment for nonadmitted (surplus lines) insurance. Home state generally means the state of the insured’s place of business or in the case of an individual, the individual’s principal residence. Premium tax means any tax, fee, assessment, or other charge imposed by a government entity directly or indirectly based on any payment made as consideration for an insurance contract.

The Act also provides that 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. Many states are now actively pursuing possible creation of an interstate compact, clearinghouse or other method to ensure that each state receives its “appropriate” share of surplus lines premium tax.

In 2010, the Service Office collected \$174.4 million in taxes and \$ 75.2 million in assessments for Citizens Property Insurance Corporation, the Florida Hurricane Catastrophe Fund, and for the Emergency Management, Preparedness and Assistance Trust Fund. Estimates from the

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<sup>8</sup> s. 626.921, F.S.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> s. 626.932, F.S.

<sup>12</sup> Pub. L. 111-203, H.R. 4173.

Service Office suggest that surplus lines premium tax collections will be reduced by approximately 10 percent as a consequence of the recent federal legislation.<sup>13</sup>

### **Competing Proposals for Interstate Allocation of Premium Taxes**

In response to and in accordance with the provisions of the NRRRA there are presently two competing efforts to form multistate compacts or agreements to allocate nonadmitted insurance premium taxes (described below). A primary purpose of such agreements is to attempt to preserve the geographic distribution and levels of premium tax collections similar to that which is occurring now, prior to the tax provisions of the federal law taking effect on July 21, 2011. At present, numerous state legislatures are considering one or both of the alternatives.

#### **National Association of Insurance Commissioners (NAIC): Nonadmitted Insurance Multistate Agreement (NIMA)**

States that participate in this agreement each agree to:

- Allocate among the applicable participating states the nonadmitted premium taxes required by an insured's home state as required by the agreement,
- Work collaboratively and in a timely manner towards the imposition of NRRRA reforms by July 21, 2011,
- Use a computer software system, agreed to by a majority of the participating states, which will allow for efficient allocation, accounting, and auditing of premium taxes, and
- Create a clearinghouse for the purpose of a single point for allocating and auditing nonadmitted insurance premium taxes to the participating states.<sup>14</sup>

The agreement requires that the amount of tax levied on nonadmitted premiums will be calculated by applying each participating state's tax rate to the exposure allocated to each state.<sup>15</sup>

#### **National Conference of State Legislatures (NCSL) & National Conference of Insurance Legislators (NCOIL): Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT)**

The purpose of SLIMPACT is broader than that for NIMA. The stated purposes are:<sup>16</sup>

- To implement the express provisions of the NRRRA,
- To protect premium tax revenues in the compacting states; support continued availability of insurance to consumers; provide for allocation of premium taxes on nonadmitted insurance of multistate risks among the states in accordance with allocation formulas to be developed, adopted and implemented by the compact's governing commission,
- To streamline and improve the efficiency of the surplus lines market by eliminating duplicative and inconsistent tax and regulatory requirements; promoting the interests of surplus lines agents,
- To streamline regulatory compliance with respect to nonadmitted insurance placements,
- To establish a clearinghouse for receipt and dissemination of premium tax and transaction data, in accordance with the rules adopted by the governing commission,

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<sup>13</sup> OIR Bill Analysis on HB 1227, March 19, 2011, on file with the Insurance & Banking Subcommittee.

<sup>14</sup> Nonadmitted Insurance Multi-state Agreement, Part 3, Paragraph 9., Implementation.

<sup>15</sup> Nonadmitted Insurance Multi-state Agreement, Part 4, Collection and Allocation Procedures.

<sup>16</sup> Surplus Lines Insurance Multi-State Compliance Compact, Article 1, Purpose.

- To improve coordination of regulatory resources and expertise between states,
- To adopt uniform rules for premium tax payment, reporting, allocation and data collection for non-admitted insurance,
- To adopt uniform mandatory rules with respect to regulatory compliance requirements for foreign insurer eligibility requirements and surplus lines policyholder notices;
- To establish a multistate compliance compact commission,
- To coordinate reporting of clearinghouse transaction data among compacting states, and
- To perform such other related functions as may be consistent with the purposes of the compact.

The Compliance Compact Commission is authorized to, among other things:

- Establish allocation formulas to help states share surplus lines taxes on multistate risks,
- Devise uniform payment methods and reporting requirements for insureds,
- Create national eligibility standards for surplus lines brokers,
- Devise a single policyholder notice to replace the various forms used across the country.

To participate in the compact a state must enact the compact legislation.

### **Effect of the Bill:**

The bill makes several changes to the way the Florida premium tax on nonadmitted insurance is collected and authorizes DFS or OIR to enter into a cooperative reciprocal agreement with other states.

The bill changes the computation of the premium receipts tax to be collected by surplus lines agents for surplus lines coverage on risks or exposures that are only partially in the state. Instead of applying the premium receipts tax to only the portion of the premium that is properly allocable to risks located in Florida, the proposed change will apply the tax to the entire gross premium, regardless of where the insured risk is located, but only if Florida is the insured's "home state" as that term is defined in the NRRRA . The tax rate is limited to the tax rate where an insured risk is located. The bill also makes the same change to the computation of the service fee collected by surplus line agents and provides that if an independently procured policy covers a risk or exposure that is only partially in Florida, and if Florida is the insured's "home state" as defined in the NRRRA, then the tax and service fee imposed are computed on the gross premium. The tax rate is also limited to the tax rate where an insured risk is located.

The bill also authorizes DFS and the OIR to enter into a cooperative reciprocal agreement with another state or with a group of states for the purpose of collecting and allocating nonadmitted insurance taxes for multistate risks pursuant to the NRRRA. The bill language is consistent with entering an agreement such as NIMA discussed above, but not SLIMPACT, since the language does not enact that compact's legislation.

The terms of any such agreement may include, but are not limited to:

- Creating a clearinghouse for the purpose of facilitating the receipt and distribution of nonadmitted insurance taxes;
- Specifying time requirements for reporting;
- Determining methods for collecting and forwarding nonadmitted insurance taxes to another state;

- Specifying a premium tax allocation formula for multistate risk nonadmitted insurance;
- Providing for audits and the exchange of information;
- Facilitating the administration of any such agreement in a reasonable manner;
- Providing for the collection of a service fee to fund the operations and activities of the clearinghouse which will not exceed 0.3 percent of the gross premium on transactions processed by the clearinghouse. The fee on gross premium allocated to Florida will be taken from premium taxes on such premiums and will not be added to said taxes; and
- Providing for the withdrawal of a participating state from the agreement, without penalty, if the withdrawing state first provides 60 days written notice to all participating states.

The bill authorizes the Service Office to implement the DFS/OIR agreement and to collect the total tax imposed on a multi-state risk nonadmitted insurance premium. The bill also authorizes DFS to adopt rules for the administration and enforcement of any such agreement.

Also, the bill affirms that the new provisions and any agreement entered into pursuant thereto control the collection and allocation of nonadmitted insurance taxes for multistate risks, notwithstanding any other provision of law.

The bill provides that following the negotiation and execution of any cooperative reciprocal agreement entered into by DFS/OIR with another state or group of states, DFS will prepare and submit a report to the President of the Senate and the Speaker of the House by January 1, 2012.

The report will include the terms of any agreement and will also include, but not be limited to, the following:

- Actual and projected collections and allocation of nonadmitted insurance premium taxes for multi-state risk of each state participating in the agreement;
- Detailed description of the administrative structure supporting any agreement, including any clearinghouse created by an agreement and the fees charged to support administration of the agreement;
- Insurance tax rates of any state participating in the agreement; and
- The status of any other cooperative reciprocal agreements established throughout the country, including a state-by-state listing of passed or pending legislation responding to changes made by the federal Nonadmitted and Reinsurance Reform Act of 2010.

The Legislature may review any such agreement and may instruct the Chief Financial Officer to withdraw from an agreement if it determines that the agreement is not in the best interest of the state.

The bill modifies current reporting and payment requirements regarding surplus lines insurance. Each surplus lines agent is presently required to file an affidavit with the Service Office stating that all surplus lines insurance transacted by him or her during each calendar quarter has been submitted. Rather than requiring that such an affidavit be filed by the end of the month next following each calendar quarter, the bill requires that each surplus lines agent file this affidavit on or before the 45<sup>th</sup> day following each calendar quarter.

Regarding payment of service fees, the bill requires that on or before the 45<sup>th</sup> day following each calendar quarter, surplus lines agents pay the service fees that were collected on all policies during the previous calendar quarter to the Service Office. This provision changes the current

requirement that these fees be paid on a monthly basis. Similarly, regarding the payment of premium taxes, the bill provides that any insured who has independently procured coverage shall on or before the 45<sup>th</sup> day following each calendar quarter, make payable to DFS the amount of the tax on the premium and to the Florida Surplus Lines Service Office the amount of any fee. This provision changes the current requirement that such payments be made within 30 days after the insurance is procured, continued, or renewed.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

### **A. FISCAL IMPACT ON STATE GOVERNMENT:**

#### **1. Revenues:**

See FISCAL COMMENTS.

#### **2. Expenditures:**

See FISCAL COMMENTS.

### **B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

#### **1. Revenues:**

None.

#### **2. Expenditures:**

None.

### **C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:**

Assessments for Citizens Property Insurance Corporation and the Florida Hurricane Catastrophe Fund will be reduced by the failure to collect “taxes” from other home state insureds. Consequently, without agreement(s) with other states the assessment burden will shift to the admitted market and property and casualty insurance policyholders will pay more in assessments.

### **D. FISCAL COMMENTS:**

On April 29, 2011, the Revenue Estimating Conference adopted an indeterminate positive estimate for both the multi-state agreement and the change to gross premium taxation. The impact of the change to gross premium taxation will be less than \$3.1 million annually.

Also, a service fee, not to exceed 0.3 percent, may be collected on insurance premiums allocated to Florida, to fund the operations of the clearinghouse. The service fee will be taken from premium taxes on such insurance premiums and not added to the tax.

Also, an Emergency Management Preparedness and Assistance (EMPA) surcharge is currently levied on surplus lines insurance policyholders, collected by the Service Office and deposited into the EMPA Trust Fund, In 2010 the Service Office collected \$952,000 in EMPA surcharges.

Unlike the premium receipts tax and the service fee (which is also based on premium dollars) the EMPA surcharge is per policy. It is reasonable to assume that there will be a decrease in revenue to the EMPA Trust Fund if cooperative reciprocal agreements with other states are not finalized.

The OIR has also stated that implementation of the legislation can be absorbed within current resources of the office.