**The Florida Senate**

# BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Budget Committee

BILL: CS/CS/CS/SB 1816

INTRODUCER: Budget Committee, Budget Subcommittee on Finance and Tax, Banking and Insurance Committee and Senators Fasano and Richter

SUBJECT: Surplus Lines Insurance

DATE: April 25, 2011 REVISED:

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|---|---|---|---|---|
| 1. | Knudson | Burgess | BI | **Fav/CS** |
| 2. | Fournier | Diez-Arguelles | BFT | **Fav/CS** |
| 3. | Fournier | Meyer, C. | BC | **Fav/CS** |
| 4. | | | | |
| 5. | | | | |
| 6. | | | | |

**Please see Section VIII. for Additional Information:**

| | | |
|---|---|---|
| A. COMMITTEE SUBSTITUTE..... | x | Statement of Substantial Changes |
| B. AMENDMENTS........................ | | Technical amendments were recommended |
| | | Amendments were recommended |
| | | Significant amendments were recommended |

## I. Summary:

Surplus lines insurance is an alternative type of insurance coverage by which consumers can buy property-liability insurance from unauthorized (non-admitted) insurers when they are unable to purchase needed coverage from admitted insurers. The premiums charged for surplus lines coverages are subject to a 5 percent tax on premiums and a service fee of up to 0.3 percent. When a surplus lines policy covers risks over multiple states, Florida requires payment of the 5 percent surplus lines tax and the 0.3 percent service fee on the portion of the premium which is properly allocable to the risks or exposures located in this state.

The Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) was included within the Federal Dodd-Frank Wall Street Reform and Consumer Protection Act. The NRRA (ss. 15 USC 8201-8206) limits regulatory authority over nonadmitted (surplus lines) insurance to the home state of the insured (policyholder). Under the NRRA, Florida will no longer have jurisdiction to collect taxes and fees on surplus lines policies that cover risks over Florida and other states unless Florida is the home state of the insured. This may result in significant loss of tax revenue. However, the NRRA authorizes states to enter into agreements with one another for home states

to collect taxes on multi-state risks and then allocate tax revenue to the state where the insured risks are located.

Senate Bill 1816 amends s. 626.932(3), F.S., to apply the surplus lines tax to the entire premium if the state is the home state of the insured as defined in the NRRA. The tax rate is limited to the tax rate where an insured risk is located. The bill also authorizes the Department of Financial Services (DFS) and the Office of Insurance Regulation (OIR) to enter into cooperative reciprocal agreements with other states to collect and allocate nonadmitted insurance taxes for multistate risks pursuant to the NRRA. The tax rate is limited to the tax rate where an insured risk is located. The Legislature is authorized to 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. Finally, the bill also provides that surplus lines agents, and insureds that do not use a surplus lines agent to procure coverage, have 45 days after the end of the calendar quarter to file an affidavit describing transactions handled during the last quarter and pay the required premium tax and fees.

This bill creates s.626.9362, F.S., and substantially amends the following sections of the Florida Statutes: 626.931, 626.932, 626.9325, and 626.938.

## II. Present Situation:

**Surplus Lines Insurance Coverage – Background**

Insurance companies that transact insurance in Florida or that have offices located in the state are required to obtain a certificate of authority (COA) issued by the Office of Insurance Regulation (OIR) pursuant to s. 624.401, F.S. These companies, referred to as authorized or admitted insurers,[1] are broadly regulated by the OIR under the Insurance Code as to reserves, surplus as to policyholders, solvency, rates and forms, market conduct, permissible investments, and affiliate relationships.[2] Authorized insurers are also required to participate in a variety of government mandated insurance programs and pay assessments levied by state guaranty funds in the event of insurer insolvencies.[3]

Surplus lines insurers are regulated by the state, but do not have to obtain a COA and are not required to adhere to the other requirements mentioned above. Surplus lines insurance is an alternative type of insurance coverage by which consumers can buy property-liability insurance from unauthorized (non-admitted) insurers when they are unable to purchase the coverage they need from admitted insurers. Surplus lines insurance is coverage provided by a company that is

[1] An "authorized" or "admitted" insurer is one duly authorized by a COA to transact insurance in this state.
[2] The Insurance Code consists of chs. 624-632, 634, 635, 636, 641, 642, 648, and 651, F.S.
[3] For example, Florida licensed direct writers of property and casualty insurance must be members of the Florida Insurance Guaranty Association, which handles the claims of insolvent insurers under part II of ch. 631, F.S., and insurers offering workers' compensation coverage in Florida must be members of the Florida Workers' Compensation Insurance Guaranty Association, which provides payment of covered claims for insurers that are declared insolvent under part V of ch. 631, F.S.

not licensed in Florida, but is allowed to transact insurance in the state as an “eligible” insurer[4] under the surplus lines law (ss. 626.913-626.937, F.S.). Under this law, insurance may be purchased from a surplus lines carrier only if the necessary amount of coverage cannot be procured after a diligent effort to buy the coverage from authorized insurers.[5] Rates charged by a surplus lines carrier must not be lower than the rate applicable and in use by the majority of the authorized insurers writing similar coverages on similar risks in Florida.[6] Likewise, a surplus lines policy contract form must not be more favorable to the insured than the coverage or rate offered by the majority of authorized carriers.[7]

The surplus lines law contains specific financial and other requirements that unauthorized insurers must comply with in order to become eligible surplus lines insurers and obtain approval by the OIR. For example, a surplus lines insurer must maintain a surplus as to policyholders of not less than $15 million and have been licensed in its state or country of domicile for at least three years.[8]

Historically, surplus lines insurers have never been held subject to Florida’s regulation of rates, forms, or other requirements under ch. 627, F.S., which governs admitted insurers.[9] This is true of the regulatory treatment of surplus lines insurers in other states across the country. The different regulatory treatment is due to the unique nature of surplus lines insurance -- it covers consumer needs arising from emerging technologies, new business practices, or changing legal environments which require a quick response that is often difficult for admitted insurers to provide, according to representatives of the Florida Surplus Lines Office.

**Florida Surplus Lines Service Office and Surplus Lines Agents**

In 1997, the Legislature created the Florida Surplus Lines Service Office (FSLSO), a non-profit association designed to act as a “self-regulating organization” to permit better access by consumers to approved surplus lines insurers.[10] The FSLSO is governed by a nine-person board of governors and is required to perform its functions under a plan of operation approved by the OIR. The FSLSO:

- Receives, records, and reviews all surplus lines insurance policies;
- Maintains records of policies;
- Prepares and delivers quarterly reports of each surplus agent’s business to each agent;
- Collects and remits the surplus lines tax; and
- Performs other activities as specified by statute.

[4] An “eligible surplus lines insurer” as defined in s. 626.914(2), F.S., is an “unauthorized insurer” which has been made eligible by the Office of Insurance Regulation to issue insurance coverage under the surplus lines law.
[5] See s. 626.914(4), F.S. A “diligent effort” is defined as seeking coverage from and being rejected by at least three authorized insurers that write the type of coverage being sought. The rejections must be documented.
[6] Section 626.916(1)(b), F.S.
[7] Section 626.916(1)(c), F.S.
[8] Section 626.918, F.S.
[9] *See Affidavits In Support of Intervenor-Plaintiff Essex Insurance Company’s Amended Motion for Summary Judgment* by Steve Parton, Office of Insurance Regulation, General Counsel, and Belinda Miller, Office of Insurance Regulation, Deputy Commissioner for Property and Casualty Insurance, filed in *Howard v. Choice Hotels International, Inc.*, Case No. CA06-680-55 (Fla. 7th Cir. Tr. Ct. 2008).
[10] Chapter 97-196, Laws of Fla. Section 626.921, F.S.

There are 1,215 licensed surplus lines agents in Florida that are authorized to handle the placement of insurance coverages with surplus lines insurers and are deemed to be members of the FSLSO. These agents are required to report and file with the FSLSO a copy of, or information on, each surplus lines insurance policy, including the name of the insured and insurer, the policy number and its effective date, the policy's expiration date, the type of coverage, the premium, and other information.

**Surplus Lines Premium Tax and Other Fees**

There are 172 surplus lines insurers writing insurance in Florida with over $4 billion in written premiums during 2009.[11] These premiums are subject to a premium receipts tax of 5 percent.[12] The surplus lines premium tax rate is more than double the rate for admitted carriers. Surplus lines premiums are also subject to a service fee of up to 0.3 percent, as determined by the FSLSO, of the total gross premium of each surplus lines policy for the cost of operation of the service office.[13] The surplus lines agent collects the tax and the service fee from the insured at the time of the delivery of the cover note, certificate of insurance, policy, or other initial confirmation of insurance. Florida also applies the premium tax and the service fee to the gross premium of policies purchased from an unauthorized insurer when the insurance is not purchased from a Florida-authorized surplus lines insurer. In 2009, the FSLSO collected $180,784,308 in taxes and $3,673,838 in fees, which was lower than the prior two years. The FSLSO collected taxes totaling $194,670,864 in 2008 and $211,285,737 in 2007. Surplus lines premiums are also subject to assessments to fund the Florida Hurricane Catastrophe Fund[14] and the Citizens Property Insurance Corporation,[15] and the $2 or $4 per policy Emergency Management Surcharge on property insurance policies.[16]

A surplus lines policy often covers risks or exposures that are located in more than one state. For example, the policy might structures owned by a single entity located across multiple states. In this instance, the surplus lines tax is computed on the portion of the premium which is properly allocable to the risks or exposures located in this state. The FSLSO has promulgated different methods of determining the taxes and service fees payable to Florida for a multi-state risk. The tax for multi-state residential property is determined by calculating the premium for structures and other property permanently located in Florida. The surplus lines agent makes the calculation and remits the proper tax and fee payment for the portion of the risk based in Florida. Representatives from the FSLSO estimate that approximately 10 percent of surplus lines premium tax revenue is attributable to taxes on multi-state risks.

**Nonadmitted and Reinsurance Reform Act of 2010**

The Nonadmitted and Reinsurance Reform Act of 2010 (NRRA) was included within the Dodd-Frank Wall Street Reform and Consumer Protection Act [H.R. 4173 (2010)]. The NRRA creates 15 USC 8201-8206, governing nonadmitted (surplus lines) insurance. The NRRA limits

[11] Florida Surplus Lines Service Office.
[12] Section 626.932, F.S.
[13] Section 626.921(3)(f), F.S.
[14] Section 215.555(6)(b), F.S.
[15] Section 627.351(6)(b)3., F.S.
[16] Section 252.372, F.S.

regulatory authority to the home state of the insured (policyholder). The insured's home state is the state in which the insured maintains its principal place of business or an individual's principal residence.

The NRRA allows only the home state of an insured to require premium tax payments (including fees and assessments) for nonadmitted insurance. However, the NRRA allows states to enter into a compact to allocate the premium taxes paid to the insured's home state to the various states where the risks are located. If the compact is enacted on or before June 15, 2011, the compact will apply to premium taxes that must be paid to states that are signatories to the compact. However, if the compact is enacted after that date, it will not be effective until January 1 of the first year after the compact is enacted.

The NRRA specifies that the placement of nonadmitted insurance is subject only to the statutory and regulatory requirements of the insured's home state.[17] Only the insured's home state may require the licensure of a surplus lines broker (agent) to sell, solicit or negotiate nonadmitted insurance with respect to that insured. Surplus lines policies purchased on risks located entirely in Florida will continue to be subject to Florida law. However, if the risk is located in multiple states, under the NRRA the home state has sole jurisdiction over all aspects of the insurance policy. For example, if a surplus lines policy is purchased on a risk covering multiple states, Florida will only have jurisdiction if Florida is the home state of the insured. If Florida lacks jurisdiction over the surplus lines policy, the state will not be able to collect premium taxes and fees on the Florida portion of the risk. Representatives from the Florida Surplus Lines Service Office indicate that Florida is likely to lose $22.1 millions in tax revenue under current law br.

## III. Effect of Proposed Changes:

**Section 1.** Amends s. 626.931(1), F.S., to allow surplus lines agents 45 days after the end of the calendar quarter to file an affidavit stating that the agent has submitted all of the agent's surplus lines transactions to the Florida Surplus Lines Service Office. Current law requires the affidavit to be filed on or before the end of the month after the end of the quarter.

**Section 2.** Amends s. 626.932(3), F.S., to specify that the surplus lines tax shall be computed on the gross premium when the surplus lines policy covers risks that are only partially in Florida and Florida is the home state as defined by the NRRA. The tax rate is limited to the tax rate where an insured risk is located.

**Section 3.** Amends s. 626.9325, F.S., to allow surplus lines agents 45 days following each calendar quarter to pay to the Surplus Lines Service Office all service fees related to policies reported during the previous quarter. Current law requires monthly payments. The fee will be computed on the gross premium when the surplus lines policy covers risks that are only partially in Florida, and Florida is the home state as defined by the NRRA.

**Section 4.** Creates s. 626.9362, F.S., to authorize the Department of Financial Services and the OIR to enter into cooperative reciprocal agreements with other states to collect and allocate

[17] The act does not preempt a state law restricting the placement of workers' compensation insurance or excess insurance for self-funded workers' compensation plans with a nonadmitted insurer.

nonadmitted insurance taxes for multistate risks pursuant to the NRRA. The agreements are authorized to create a comprehensive system for reporting, collecting, and allocating these taxes. The agreement may:

- Create a clearinghouse to receive and disburse nonadmitted insurance taxes;
- Create reporting requirements;
- Determine the methods for collecting and forwarding taxes to the appropriate state;
- Develop a premium tax allocation formula for multi-state nonadmitted risks;
- Provide for audits and exchanging information; and
- Facilitate the reasonable administration of the cooperative reciprocal agreement.
- Provide for a service fee of up to 0.3 percent of gross premium on transactions processed by the clearinghouse to fund the operations of the clearinghouse.

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 OIR and the DFS are granted rulemaking authority to administer agreements reached with other states.

The Legislature is authorized to review any cooperative reciprocal agreement, and, if the Legislature determines that the cooperative agreement is not in the best interest of the state ,it shall instruct the Chief Financial Officer to withdraw from the agreement.

After the execution of a cooperative reciprocal agreement, DFS is directed to report to the President of the Senate and Speaker of the House of Representatives on the terms of the agreement. The report must include:

- the actual and projected collections and allocations of nonadmitted insurance premium taxes for multistate risk for each participating state,
- a detailed description of the administrative structure of the agreement,
- the tax rates of any participating state, and
- the status of other cooperative reciprocal agreements established throughout the country, including a state-by-state listing of passed or pending legislation responding to the NRRA.

**Section 5.** Amends s. 626.938(3), F.S., to require that insureds that do not use a surplus lines agent to procure surplus lines coverage must pay the surplus lines premium tax and the service fee within 45 days following each calendar quarter in which the insurance was procured. Current law requires payment within 30 days after the insurance is procured. The section also specifies that the surplus lines tax paid by the insured shall be computed on the gross premium when the surplus lines policy covers risks that are only partially in Florida and Florida is the home state as defined by the NRRA. The tax rate is limited to the tax rate where an insured risk is located.

## IV. Constitutional Issues:

### A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

Statutory authorization to compact or enter reciprocal agreements with other states potentially implicates the "nondelegation doctrine." Article III, Section 1 of the Florida Constitution states that "[t]he legislative power of the state shall be vested in a legislature of the State of Florida." The Florida Supreme Court has held that this constitutional provision requires application of a "strict separation of powers doctrine...which `encompasses two fundamental prohibitions'." *Fla. Dep't of State, Div. of Elections v. Martin*, 916 So.2d 763, 769 (Fla. 2005) (quoting *State v. Cotton*, 769 So.2d 345, 353 (Fla. 2000), and *Chiles,* 589 So.2d at 264). No branch of Government may delegate its constitutionally assigned powers to another branch. *Chiles,* 589 So.2d at 264.

The Legislature may constitutionally transfer subordinate functions to "permit administration of legislative policy by an agency with the expertise and flexibility to deal with complex and fluid conditions." *Microtel v. Fla. Pub. Serv. Comm'n*, 464 So.2d 1189, 1191 (Fla.1985) (citing *State, Dep't of Citrus v. Griffin*, 239 So.2d 577 (Fla.1970)). However, the Legislature "may not delegate the power to enact a law or the right to exercise unrestricted discretion in applying the law." *Sims v. State*, 754 So.2d 657, 668 (2000). Further, the nondelegation doctrine precludes the legislature from delegating its powers "absent ascertainable minimal standards and guidelines." *Dep't of Bus. Reg., Div. of Alcoholic Beverages & Tobacco v. Jones*, 474 So.2d 359, 361 (Fla. 1st DCA 1985). When the Legislature delegates power to another body, it "must clearly announce adequate standards to guide ... in the execution of the powers delegated." *Martin, 916 So.2d at 770.*

## V. Fiscal Impact Statement:

A. Tax/Fee Issues:

Under the provisions of the NRRA, after the expiration of a 330 day period that began on July 1, 2010, Florida will not have jurisdiction to collect taxes, assessments, and fees on surplus lines policies that cover multi-state risks unless Florida is the home state of the insured. This bill amends Florida Statutes to tax the gross premium if Florida is an insured's "home state" as defined in the NRRA, but the tax rate for multistate risks is limited to the rate in effect where each risk is located. The impact of this provision is a has not been analyzed by the Revenue Estimating Conference.

The bill also authorizes the DFS and OIR to enter into a cooperative reciprocal agreement with other states to collect and allocate surplus lines insurance taxes for multi-state policies. The impact of this provision is positive but indeterminate to the General Revenue Fund.

As a result of the NRRA, assessment revenue from surplus lines premiums is expected to decrease by $7.5 to $17.5 million.[18] In order to make up for this loss in revenue, assessments on other premiums are expected to increase. This bill will mitigate the assessment revenue loss to the extent that surplus lines premiums remain subject to taxation and assessment by this state.

B. Private Sector Impact:

The creation of a uniform clearinghouse to collect information, taxes, and fees related to surplus lines insurance on multi-state risks will be less burdensome to surplus lines agents and entities purchasing such insurance. Currently, agents must file reports and pay taxes to multiple different states and perform calculations regarding the appropriate tax revenues due the various states.

To the extent that this bill keeps surplus lines premiums subject to assessment by this state, other Florida insurance policy holders will be spared an increase in assessments on their premiums.

C. Government Sector Impact:

Representatives from the OIR state that implementation of the legislation can be absorbed within current resources of the office.

## VI. Technical Deficiencies:

None.

## VII. Related Issues:

None.

## VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**CS by Budget Committee on April 25, 2011”**
The CS provides that tax rate for multistate risks is limited to the rate in effect where each risk is located. It also authorizes the Legislature to review any cooperative reciprocal agreement and to 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.

[18] Florida Surplus Lines Service Office.

**CS by Budget Subcommittee on Finance and Tax on April 13, 2011:**
The CS allows the multistate agreement to provide for a service fee of up to 0.3 percent of gross premium on transactions processed by the clearinghouse to fund its operations.

**CS by Banking and Insurance Committee on March 22, 2011:**
The committee substitute corrects drafting errors to the bill.

B. Amendments:

None.