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 Banking and Insurance Committee

BILL: SB 1816

INTRODUCER: Senators Fasano and Richter

SUBJECT: Surplus Lines Insurance

DATE: March 18, 2011 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Burgess	BI	**Pre-meeting**
2.			BC	
3.				
4.				
5.				
6.				

I. Summary:

Surplus lines insurance is an alternative type of insurance coverage for consumers to buy property-liability insurance from unauthorized (non-admitted) insurers when consumers are unable to purchase the coverage they need from admitted insurers. The premiums charged for surplus lines coverages are subject to a premium receipts tax of 5 percent and a service fee of up to .3 percent. When a surplus lines policy covers risks over multiple states, Florida requires payment of a 5 percent surplus lines tax and the .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 creates 15 USC 8201 through 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 multiple states unless Florida is the home state of the risk. This may result in the loss of tax revenue in the millions of dollars. However, the NRRA authorizes states to enter agreements with one another that provide for the collection of taxes on multi-state risks by the home state and then allocate tax revenue to the appropriate state.

Senate Bill 1816 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 bill also provides 45 days after the end of the calendar quarter for surplus lines agents and insureds that do not use a surplus lines agent to procure coverage to file an affidavit describing transactions handled during the last quarter and pay the required premium tax and fees.

This bill substantially amends the following sections of the Florida Statutes: 626.931, 626.932, 626.9325, 626.9362, 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 for consumers to buy property-liability insurance from unauthorized (non-admitted) insurers when consumers are unable to purchase the coverage they need from admitted insurers. Surplus lines insurance is coverage provided by a company that is 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 only be purchased from a surplus lines carrier 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 as to 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

[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.
[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.

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., as are 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 because 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 with 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 to each surplus lines agent quarterly reports of each agent's business;
- Collects and remits the surplus lines tax; and
- Performs other activities as specified by statute.

There are 1,215 licensed surplus lines agents in Florida which 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] The premiums charged for surplus lines coverages are subject to a premium receipts tax of 5 percent.[12] The surplus lines premium tax is more than double the percentage for admitted carriers. Surplus lines premiums are also subject to a service fee of up to 0.3 percent, as determined by the office, of the total gross premium of each surplus lines policy

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[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.
[11] Florida Surplus Lines Service Office.
[12] Section 626.932, F.S.

for the cost of operation of the service office.[13] 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 or through the FSLSO. The surplus lines agent collects the tax, 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. In 2009, the FSLSO collected $180,784,308 in taxes and $3,673,838 in fees. The 2009 revenue constituted a decrease from the prior two years. The FSLSO collected taxes totaling $194,670,864 in 2008 and $211,285,737 in 2007.

A surplus lines policy will often cover risks or exposures that are only partially in this state. For instance, the policy might cover multiple structures 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 multistate 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 Federal 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 regulatory authority to the home state of the insured (policyholder). The insured's home state is the state in which the insured maintains its principle place of business or an individual's principal residence.

The NRRA allows only the home state of an insured to require premium tax payments 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. 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 only subject to the statutory and regulatory requirements of the insured's home state.[14] Only the insured's home state may require the licensure of a surplus lines broker (agents) 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,

[13] Section 626.921(3)(f), F.S.
[14] 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.

Florida will only have jurisdiction if Florida is the home state of the risk. 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 Office of Insurance Regulation and the Florida Surplus Lines Service Office indicate that Florida is likely to lose millions of dollars in tax revenue if the state is unable to collect surplus lines premium taxes on multistate risks.

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.

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.

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. The fee is 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 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.

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.

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. 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.

<u>Other Potential Implications</u>:

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 implicate 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:

The Florida Surplus Lines Service Office estimates that approximately 10 percent of the current premium tax collected could be lost to other states due to the NRRA's requirement that only the home state of the insured may require the payment of premium taxes. The FSLSO estimates a potential loss of $15-20 million to the state's general revenue collections. Much of this revenue should be recaptured if Florida successfully enters into reciprocal agreements with a large number of states.

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.

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:

Section 5 of the bill incorrectly requires payment of the surplus lines premium tax after each calendar quarter.

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.)

None.

B. Amendments:

None.