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**Business & Financial Services Committee**

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**HB 1694**

**Brief Description:** Regulating unauthorized insurance.

**Sponsors:** Representatives Stanford and Kirby; by request of Insurance Commissioner.

**Brief Summary of Bill**

- Modifies taxation provisions regarding surplus lines premiums.
- Exempts surplus lines purchases by certain commercial purchasers from the diligent effort search by a surplus lines broker.
- Makes changes to the reporting requirements of surplus lines brokers.

**Hearing Date:** 2/1/11

**Staff:** Jon Hedegard (786-7127).

**Background:**

Surplus Lines Insurance.

Generally, an insurance company cannot engage in the business of insurance in the state unless the insurance company is authorized to do so by the Office of the Insurance Commissioner (OIC). "Surplus lines" insurance coverage is an exception. Surplus lines insurance is coverage that cannot be procured from authorized insurance companies. Often, surplus lines policies cover risks that do not fit normal underwriting patterns or fit standard insurance policies. Unlike insurance offered by an authorized insurer, surplus lines insurance is not subject to rate and policy form oversight. Under insurance statutes, if coverage cannot be purchased from an authorized insurer, the coverage may be purchased from an unauthorized insurer through a licensed surplus lines broker if:

- a diligent effort is made to find the coverage from authorized insurers; and
- the purpose for using an unauthorized insurer is something other than securing a lower premium rate than would be accepted by any authorized insurer.

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

The surplus lines broker must execute an affidavit setting forth the facts regarding the diligent effort and the purpose for using an unauthorized insurer when insurance is purchased from an unauthorized insurer. The affidavit must be filed with the OIC within 30 days after the purchase of the insurance.

Licensing requirements regarding surplus line brokers include:

- background checks, including fingerprints;
- minimum bonding amounts;
- record-keeping; and
- reporting.

#### Capital Requirements for Unauthorized Insurers.

A surplus line broker must not knowingly place surplus line insurance with an insurer that is not financially sound. The surplus line broker must determine and document the financial condition of the unauthorized insurer before placing insurance with the insurer. The surplus line broker may not place insurance with:

- any foreign insurer unless the insurer has at least one million five hundred thousand dollars in capital and six million dollars of capital and surplus; or
- any alien insurer having unless the insurer has 15 million dollars of capital and surplus and meets specific requirements regarding the manner in which alien insurers must hold fund;
- any group including incorporated and individual insurers unless the group maintains a trust fund of 50 million dollars as security and meets specific requirements regarding the manner in which the group must hold fund; or
- any insurance exchange created by the laws of a state unless the exchange maintains capital and surplus of 50 million dollars in the aggregate and meets other specific requirements for exchanges.

#### Surplus Lines Premium Tax.

A surplus line broker must pay a premium tax of two per cent on surplus line insurance transacted by the broker. The tax is credited to the General Fund. If a surplus line policy covers risks or exposures that are only partially located in this state, the tax is computed upon the proportion of the risks or exposures located in this state.

In 2010, federal legislation (House Resolution 4173 or the Dodd-Frank Wall Street Reform and Consumer Protection Act) included provisions that addressed surplus lines regulation. The federal law:

- provides definitions;
- precludes any state other than the home state of an insured from taxing premium on surplus lines insurance.
- allows the states to enter into a compact to allocate taxes on risks that involve more than one state;
- limits the regulation of the placement of surplus lines insurance to the requirements of the insured's home state, including the licensure of surplus lines brokers;
- prohibits a state from imposing a due diligence search on a surplus lines broker when the broker is seeking to procure insurance for an exempt commercial purchaser and certain criteria are met.

- prohibits states from collecting any fees relating to licensing of a surplus lines broker unless the state has laws or regulations that provide for participation by the state in a national uniform national database, for the licensure of surplus lines brokers;
- prohibits a state from imposing eligibility requirements on surplus lines insurers domiciled in the United States unless the state has adopted nationwide uniform requirements, forms, and procedures, including alternative nationwide uniform eligibility requirements;
- prohibits states from preventing a surplus lines broker from placing surplus lines insurance with certain surplus lines insurers.

### **Summary of Bill:**

#### Insured's Home State.

"Insured's home state" is defined as:

- for a business, the state where an insured maintains its headquarters and where the insured's high-level officers direct, control, and coordinate the business activities of the insured;
- for an individual, the individual's principal residence; or
- the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated if the entire insured risk is located out of this state.

If more than one insured from an affiliated group are named insureds on a single insurance contract issued by an unauthorized insurer, the insured's home state is the home state of the member of the affiliated group that pays the largest percentage of premium.

#### Surplus Lines Premium Tax.

For property and casualty insurance, if this state is the insured's home state, the tax is computed upon the entire premium without regard to whether the policy covers risks or exposures that are located in this state. For all other lines of insurance, the tax is computed upon the proportion of the premium that is properly allocable to the risks or exposures located in this state.

#### Exemption for Certain Commercial Purchasers.

A person is an "exempt commercial purchaser" if the person meets the following requirements the person:

- employs or retains a qualified risk manager to negotiate insurance coverage;
- has paid aggregate commercial property and casualty insurance premiums exceeding one hundred thousand dollars in the previous year; and
- meets additional financial criteria.

A surplus line broker seeking to procure from or place insurance with an unauthorized insurer for an exempt commercial purchaser is not required to satisfy the diligent effort requirement if the:

- surplus line broker or referring insurance producer placing the surplus line insurance discloses that the insurance may or may not be available from the admitted market that may provide greater protection with more regulatory oversight; and
- exempt commercial purchaser has subsequently requests the surplus line broker or referring insurance producer in writing to procure or place such insurance from an unauthorized insurer.

### Affidavits.

The "affidavit" is replaced by a "certification." The certification may be in electronic, digital, or other format or form as designated by the OIC. There is specific language requiring the surplus lines broker to certify that the information is true and correct under the penalty of license suspension or revocation. The filing period is extended from 30 days to 60 days.

### Capital Requirements for Unauthorized Insurers.

A surplus line broker may only place insurance with:

- a foreign insurer authorized to write the same type of insurance in its domiciliary jurisdiction that has capital and surplus equal to the greater of the minimum capital and surplus requirements of this state or 15 million dollars. The OIC may waive the financial requirements if the foreign insurer's capital and surplus is at least than four million five hundred thousand dollars and the OIC finds the insurer is acceptable;
- an alien insurer that is on the quarterly listing of alien insurers maintained by the National Association of Insurance Commissioners.

Specific requirements regarding groups and exchanges are struck.

### Other.

The OIC is authorized to participate in a uniform national database for the licensure of surplus lines brokers if such a database is created.

**Appropriation:** None.

**Fiscal Note:** Requested on January 31, 2011.

**Effective Date:** The bill contains multiple effective dates. Sections 1, 2, and 4-9, providing all of the substantive provisions of the bill, are subject to an emergency clause and take effect July 21, 2011. Section 3 is effective on December 31, 2016. This section is parallel to section 2 except section 3 does not include a reference to the joint underwriting authority for excess flood insurance (Flood JUA) which will have expired. Section 2 expires on December 31, 2016.