



**National Association of
Professional Surplus Lines
Offices, Ltd.**

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**Testimony of
The National Association of Professional Surplus Lines Offices**

**Before the
House Financial Services Committee
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NAPSLO is the national trade association representing the surplus lines industry and the wholesale insurance distribution system. Since its founding in 1974, NAPSLO has become the authoritative voice of the surplus lines industry, advocating for the industry's vital role in the insurance marketplace and global economy. The surplus lines market plays an important role in providing insurance for hard-to-place, unique or high capacity (i.e., high limit) risks. Often called the "safety valve" of the insurance industry, surplus lines insurers fill the need for coverage in the marketplace by insuring those risks that are declined by the standard underwriting and pricing processes of admitted insurance carriers. With the ability to accommodate a wide variety of risks, the surplus lines market acts as an effective supplement to the admitted market.

Surplus lines insurers are able to cover unique and hard-to-place risks because, as nonadmitted insurers, they are able to react to market changes and accommodate the unique needs of insureds that are unable to obtain coverage from admitted carriers. This results in cost-effective solutions for consumers that are not "one size fits all," but are instead skillfully tailored to meet specific needs for non-standard risks.

NAPSLO's membership consists of approximately 400 brokerage member firms, 100 company member firms and 200 associate member firms, all of whom operate over 1,500 offices representing approximately 15,000 to 20,000 individual brokers, insurance company professionals, underwriters and other insurance professionals in the 50 states and the District of Columbia. NAPSLO is unique in that both surplus lines brokers and surplus lines companies are full members of the association; thus NAPSLO represents and speaks for the surplus lines wholesale marketplace. We appreciate the opportunity to submit testimony to today's hearing.

Background

NAPSLO has reviewed the Federal Insurance Office's (FIO) report "How to modernize and improve the System of Insurance Regulation in the United States" in the context of the association's long standing and unwavering support of the state based system of insurance regulation. NAPSLO is heartened that the FIO recommendations and analysis strongly supports the state based system of insurance regulation. NAPSLO is pleased with the FIO's call for enactment of the National Association of Registered Agents and Brokers, to provide a uniform and streamlined licensing process for agents and brokers nationwide, which NAPSLO and many other industry associations and state regulators through the NAIC strongly support. While the report focuses on a number of important insurance regulatory issues, NAPSLO will limit the remainder of its comments to those sections that focus on the surplus lines industry; specifically, material related to the Nonadmitted and Reinsurance Reform Act of 2010 (NRRRA) found in Section IV *Marketplace Oversight, Consumer Protection and Access to Insurance*.

In passing the NRRRA, Congress sought to achieve a simpler and more efficient system of regulation and taxation of the surplus lines industry by establishing the insured's "home state" as the one and only

jurisdiction to regulate and tax surplus lines transactions. In the law, Congress also clearly expressed its intent that states establish a uniform, nationwide approach to the regulation and taxation of the surplus lines industry.

NRRA Benefits, Improvements and Reforms

Since its passage, the NRRA has produced significant benefits for the surplus lines industry. Its “home state” approach has brought efficiency, clarity and uniformity to the regulation and taxation of surplus lines insurance by creating a modern and efficient regulatory framework. Consequently, NAPSCO remains a strong supporter of the law and the reforms it mandates and wishes to express its great appreciation to Congress for enacting the NRRA and to the states for their work and significant progress in implementing the law.

While the FIO report commented briefly on the NRRA, the report only commented on the tax sharing aspect of NRRA law and its implementation. Subsequently, the report does not describe the many other benefits and improvements in the regulation and taxation of surplus lines that resulted from the NRRA. Simply and briefly, these reforms include the adoption by forty-nine states of the “home state” approach, as set forth in the NRRA, to the regulation of surplus lines transactions. Before the NRRA was enacted, surplus lines brokers and insurers were often faced with inconsistent requirements governing all aspects of the insurance placement, depending on the state where the risk was located or the state where the transaction occurred. A multi-state risk became even more complex and difficult, because each state with any portion of the underlying risk had regulatory jurisdiction over the transaction. The NRRA’s “home state” approach has corrected this problem and has brought a degree of uniformity to the regulatory requirements for every surplus lines transaction in the country.

Home State Taxation—Almost There

Currently, forty-six states, representing more than 80% of nationwide surplus lines premium, now collect and retain 100% of the surplus lines premium tax paid to them as the “home state” of the insured. The January 2014 report of the U.S. Government Accountability Office, “Effects of the Nonadmitted and Reinsurance Reform Act of 2010,” noted the home state provision has produced significant benefits for the surplus lines industry by reducing the need for brokers and insurers to comply with differing sets of rules, disclosures and requirements.

Unfortunately, in July 2012, six jurisdictions, Florida, Louisiana, Puerto Rico, South Dakota, Utah and Wyoming, established a tax sharing clearinghouse pursuant to the Nonadmitted Insurance Multistate Agreement (NIMA). Many industry representatives, including NAPSLO, continue to question the cost/benefit of NIMA or any similar approach to tax sharing. NAPSLO strongly believes that the cost of supporting any tax sharing system will exceed the benefits derived from the insignificant tax reallocations among participating states. Such is true for the NIMA states. Based on preliminary data from NIMA’s surplus lines clearinghouse, we anticipate the 0.30% filing fee incurred by surplus lines brokers for filing through the system will likely exceed the net amount of taxes reallocated among the NIMA jurisdictions. For these reasons, NAPSLO continues to advocate for implementation of the home state tax approach nationwide. We believe the only option for complete uniformity is the home state tax approach as currently implemented in the vast majority of the states.

The FIO reported that a “compact seems no more likely than before the NRRRA became law.” NAPSLO agrees with this statement and believes that any efforts to perpetuate tax sharing should be abandoned in favor of home state taxation nationwide. Indeed, as former Representative Dennis Moore (D-KS),

author of the NRRRA said, “the letter and spirit of the NRRRA [are] to provide a simpler, uniform tax reporting and payment process.”

Implementation of National Eligibility Standards—More Work Needed

Another key reformation intended by the NRRRA relates to the “national standards” for eligibility of surplus lines insurers. Before the NRRRA, the industry faced a plethora of inconsistent standards employed by the various states in determining whether a surplus lines insurer would be “eligible” or “listed” to insure risks under each state’s surplus lines law. Consequently, brokers often found themselves frustrated and their clients confused when they discovered that a company “eligible” or “listed” in one state did not meet the “eligibility” or “listing” requirements in another state where a portion of the insured risk was located or to be performed. To solve this problem, Congress set forth, in Section 524 of the NRRRA, uniform national criteria for determining the eligibility of U.S. based companies to write surplus lines insurance. The NRRRA’s intent was to make it easier for a nonadmitted insurer that meets the NRRRA eligibility criteria to become eligible to conduct surplus lines business in all states where it wishes to write surplus lines insurance.

In response to the NRRRA, several states have revised their pre-NRRRA eligibility and/or “white lists” requirements. However, our work continues to ensure all states fully embrace the NRRRA eligibility standards in order to achieve the full intent of the law.

Conclusion

The NAPSLO membership believes the greatest benefit of the NRRRA is the efficiency brought about by home state regulation and taxation. There remains tremendous opportunity to improve uniformity in

forms, filing requirements, dates and procedures for the reporting and payment of surplus lines premium taxes. Beyond the uniformity achieved with the home state approach, NAPSLO, like the FIO, believes the NRRRA affords the states an excellent opportunity to demonstrate their ability to modernize and work collaboratively to further reduce the complexity and cost of unique compliance rules and requirements across state lines. We appreciate the FIO's comments on the surplus lines industry and the NRRRA report and thank you for this opportunity to provide additional perspective on the FIO's report.