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TESTIMONY FOR THE RECORD OF THE NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS LINES OFFICES BEFORE THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY HEARING ENTITLED, "INSURANCE OVERSIGHT: POLICY IMPLICATIONS FOR CONSUMERS, BUSINESSES AND JOBS."

July 28, 2011

The National Association of Professional Surplus Lines Offices (NAPSLO) is pleased to submit the following testimony to the House Financial Services Committee, Subcommittee on Insurance, Housing and Community Opportunity regarding the impact of the surplus lines insurance reforms in the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

NAPSLO is a national trade association representing the surplus lines industry and the wholesale insurance marketing system. NAPSLO is the only association to represent both surplus line companies and brokers. Founded in 1974, NAPSLO has concentrated on being a trusted voice on surplus lines issues in all fifty (50) states, as well as in Washington, DC. NAPSLO is a valuable source of information regarding the vital role surplus lines plays in the insurance industry. NAPSLO has over 750 members representing 1,600 offices representing approximately 15,000 – 20,000 individual brokers, agents, company professionals, underwriters and other insurance professionals in 48 states and the District of Columbia.

The surplus lines reforms of the *Nonadmitted and Reinsurance Reform Act* ("NRRA") that passed as Title V, Part I of the *Dodd-Frank Act* were broadly supported, much needed, and intended to significantly simplify the nonadmitted insurance market. Unfortunately, as explained below, certain state interpretation and implementation of the NRRA has, in NAPSLO's view, been inconsistent with Congress's intent. NAPSLO's testimony will provide:

- background on the surplus lines industry and why the NRRA reforms were needed,

- a summary of the status of state implementation activities,
- an explanation on why NAPSLO has serious concerns about the NAIC's proposed tax sharing scheme, called "NIMA," and
- support for a formula that would improve state NRRA implementation for the benefit of all stakeholders.

<u>Background on Surplus Lines Insurance Industry</u>

Surplus lines is property and casualty insurance that covers unique, unusual, hard-to-place or non-standard risks for which insurance is not typically offered by insurers operating in the licensed or "admitted" or standard marketplace. Often referred to as "non-admitted" insurance, surplus lines covers risks that state-licensed or "admitted" companies are unable to or will not insure or do not meet the insurance requirements of the buyer.

The need for an insurance buyer to access the surplus lines insurance market can stem from an inability of standard or admitted companies to effectively evaluate a particular risk because of the risk's unique, novel or difficult underwriting characteristics or because of the lack of sufficient statistical information about the risk or that class of risk that would allow standard company underwriters to sufficiently analyze it. Some unusual risks include kidnappings, ransoms, business interruptions, environmental impairment, special events, amusement rides, and coastal properties, as well as general, professional and business liability coverage for those risks with unique, difficult or "challenging" underwriting characteristics. The need for surplus lines treatment may also evolve from the fact that a buyer may desire a level or limits of coverage on a risk that exceed that which standard or admitted companies are willing or able to offer. Thirty-three billion dollars in annual premiums were written in 2009 by surplus lines carriers. This figure represents over 13% of the total annual amount of commercial property/casualty insurance premium.

<u>Why Title V, Part I of the *Dodd-Frank Act* ("NRRA") was Needed</u>

For years the surplus lines insurance community – regulators and industry alike – recognized the need to streamline the regulation of the surplus lines industry and modernize surplus lines tax reporting and allocation procedures. During this time, NAPSLO was an active advocate in support of Title V, Part I of the *Dodd-Frank Act*, the *Nonadmitted and Reinsurance*

Reform Act (NRRA), as the way to fix the complex and often conflicting patchwork of state surplus lines laws and procedures that burdened brokers and companies.

The NRRA was passed to address the inconsistent way in which states manage their premium tax allocation and remittance schedules. The proper allocation and remittance of surplus lines premium taxes to the states on multi-state risks had been a growing problem for over a century. The passage of the Gramm-Leach-Bliley Act (GLBA) in 1999 added to the severity of this burden by increasing the number of non-resident surplus lines broker licenses. GLBA "compelled" states to grant reciprocal licenses through a threat of preemption, and, as more surplus lines brokers obtained nonresident surplus lines licenses, they quickly discovered that state laws fail to provide guidance on which state surplus lines law governs a multi-state surplus transaction.

The failure of the states to establish a uniform and consistent method of remitting surplus lines premium taxes on multi-state surplus lines risks brought forth confusion and complexity in the market from the standpoint of the consumers as well as the producers. For almost two decades, the National Association of Insurance Commissioners (NAIC) tried, unsuccessfully, to solve the problem through initiatives to harmonize the inconsistencies. Over time, however, the severity of this problem increased, since more and more surplus lines placements have become multi-state risks. The genesis of this problem lies in the contradictory and inconsistent state regulatory and tax laws, which make multi-state surplus lines transactions complicated, confusing, and very costly to all parties.

The NRRA sought to remedy two primary types of inconsistencies and conflicts in state laws. First, there was no universally accepted allocation formula among states: meaning the broker had to determine which state's allocation formula governed the multi-state transaction and, when the state laws conflicted, the broker had to try to use some rational basis for allocating taxes to each state.

The second regulatory breakdown involved licensing standards. Prior to the NRRA, there were true safeguards to prevent licensing discrimination against nonresident agents and brokers, and the lack of clarity created a varying regulatory climate which changes, for better or for worse, according to the jurisdiction in which you operate. The NRRA addressed this problem by adopting uniform standards for producer licenses. It also mandates that no

jurisdiction other than an insurer's home state may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate non-admitted insurance. The NRRA also contemplates a national producer database which will assist with the proper collection of licensing fees for non-admitted brokers. Multiple compliance requirements for surplus lines brokers is fraught with bureaucratic red tape, and NAPSLO has long been a proponent of reciprocal participation across jurisdictions.

To illustrate the point, consider a broker who has exposures in five (5) different states; does this constitute the application of five (5) separate state laws and five (5) different tax filings? Does this require five (5) diligent searches and five (5) different license requirements? Now imagine how this problem would translate nationwide with an exposure in fifty (50) states. This is nothing short of a recipe for disaster, and further demonstrates the regulatory problems that the NRRA intended to resolve.

As envisioned by Congress and supported by all stakeholders, the NRRA would both streamline tax payment processes and to make more uniform, simple, and efficient licensing standards and other aspects of surplus lines regulation to enable brokers to more easily and efficiently comply with state requirements. As expressed by one of the bill's primary sponsors, Congressman Dennis Moore:

"The goal of the NRRA was not to eliminate regulatory protections, but to streamline the regulatory regime to enable insurers and brokers to more easily and efficiently comply with state rules and provide much-needed insurance protections to consumers. The law accomplishes this by giving sole regulatory authority over a surplus lines transaction—including the authority to collect premium taxes—to the home state of the insured."

Since passage of the *Dodd-Frank Act*, states and stakeholders have been working with varying levels of success on implementation of the NRRA in anticipation of the July 21, 2011 effective date.

State Implementation

Immediately after the passage of the *Dodd-Frank Act*, NAPSLO offered to help the NAIC, state policymakers and regulators, insurance brokers and companies with NRRA implementation and ongoing compliance. For example:

- In early 2011 NAPSLO, along with the American Association of Managing General Agents (AAMGA) and the Council of Insurance Agents & Brokers (CIAB), provided clear recommendations to state legislators and insurance commissioners on the mandatory provisions of the NRRA.
- At the same time, NAPSLO also provided draft NRRA implementing legislation to all states, began meeting with state legislators and insurance commissioners in almost every state, provided testimony at state hearings, and drafted amendments to legislation – all in an effort to increase the likelihood that each state's implementing legislation would be consistent with Congress's intent for the NRRA.

To date, 43 states have passed some sort of NRRA implementing legislation, and:

- 3 states – Iowa, Illinois, and Colorado – adjourned without taking action;
- 4 states – Michigan, Wisconsin, Massachusetts, and South Carolina, and the District of Columbia – have not yet passed any legislation, and
- 3 states have approved legislation that is awaiting action by the Governor – Delaware, Oregon and New Jersey.

A handful of the 43 states that have take action, as well as the NAIC, have offered guidance and/or bulletins to brokers regarding the new "home state" rules for multi-state risks and other aspects of NRRA compliance. NAPSLO appreciates the leadership these entities have demonstrated, and urges all states to issue the NAIC Model Bulletin.

Despite the appropriate and much needed guidance issued by a handful of entities, NAPSLO is increasingly concerned that the NRRA is being implemented in many states (even as promoted by NAIC) in such a way that they'll make things worse – not better – for surplus lines stakeholders. As explained, the NRRA and its legislative history provide that the law was intended to both streamline tax payment processes for brokers and to make more uniform, simple, and efficient other aspects of surplus lines regulation. Thus, by giving the "home state" the sole authority to regulate the surplus lines broker, the NRRA would enable brokers to more easily and efficiently comply with state requirements. Unfortunately, most states are focusing their attention on the tax payment and allocation issues, while neglecting the law's other goal – to make more uniform, simple, and efficient other aspects of surplus lines regulation.

Improper Emphasis on Tax Sharing

There are two competing approaches for sharing multi-state surplus lines taxes:

1) Surplus Lines Insurance Multistate Compliance Compact ("SLIMPACT-Lite") which has been passed by nine (9) states and is supported by National Conference of Insurance Legislators (NCOIL), the Council of State Government (CSG), National Conference of State Legislators (NCSL) and industry stakeholders, and
2) The Nonadmitted Insurance Multistate Agreement ("NIMA") proposed by the NAIC.

Attached as Exhibit 1 is a side-by-side comparison of SLIMPACT-Lite and NIMA.

While there remain numerous uncertainties over how the NIMA system would work, NAPSLO believes that the underlying proposal does not fulfill the intent of Congress to establish an efficient and uniform landscape for the industry. NAPSLO is not alone in this view; surplus lines attorney Rick Brown also finds fault with the NIMA approach; attached as Exhibit 2 is his paper "An Analysis of the Nonadmitted Insurance Multi-state Agreement."

Simply put, NIMA states and the NAIC seem to be putting the prospect of money in the form of premium tax revenues before the letter and spirit of the surplus lines reforms passed in the *Dodd-Frank Act*. Specifically, to date, twelve (12) states have legislatively approved joining the NAIC's tax-sharing agreement, called the Nonadmitted Insurance Multistate Agreement ("NIMA"), and a number of states have already signed an agreement to be part of this system. These states are prioritizing the voluntary tax-sharing provisions in the NRRA while ignoring the other regulatory efficiencies intended by the law. Moreover, states are spending time and energy focusing on NIMA even while the NIMA system remains months away from being operational. A vendor has yet to be selected to manage the central clearinghouse, though we've heard that the NAIC itself has proposed to operate NIMA -- so that, for a fee, the NAIC would collect and allocate multi-state taxes.

Problems with the NIMA Tax Allocation Methodology

NAPSLO and other industry stakeholders have consistently opposed the NIMA tax sharing system because, as currently drafted, it:

- Fails to create the non-tax regulatory efficiencies or uniformities envisioned by Congress;
- Violates the NRRA requirement that "no state other than the home state . . . may require any premium tax payments for nonadmitted insurance," and;
- Involves unnecessary and burdensome data reporting by brokers for the sole purpose of collecting taxes, including novel allocation requirements for casualty lines.

Specifically, NAPSLO strongly opposes NIMA's current tax allocation methodology as it is wholly unworkable for the vast majority of the industry, and if implemented will result in new costs and fees levied on surplus lines consumers. Attached as Exhibit 3 is document detailing the real-life problems surplus lines brokers have with the proposed NIMA tax allocation methodology.

To be consistent with the new federal law, NAPSLO believes that if states are going to share surplus lines premium taxes – something not required by the NRRA, the tax sharing methodology must be designed so that it:

- relies on existing data, rather than requiring the creation of new categories of information,
- is consistent with current industry practice, and
- respects the home-state rule that was established under the NRRA.

NAPSLO's Efforts to Improve the NIMA Tax Allocation Methodology

For almost a year NAPSLO has been trying to work with the NAIC, the Surplus Lines Task Force, and NIMA state leaders to fix the NIMA tax methodology to the benefit of all stakeholders, yet our pleas have fallen on deaf ears. What is more, we've recently heard from the NAIC and NIMA leaders that NAPSLO is "too late" in proposing alternatives to the NIMA allocation methodology, and that we should have spoken up sooner. To debunk this myth, is a detailed timeline showing NAPSLO's efforts to fix the NIMA allocation methodology. This timeline shows that NAPSLO has been clear and consistent from the moment this allocation approach was introduced that it is not workable and must be changed. In short, for six months

industry representatives were ignored, and then for the last two months NAPSLO have been given lip service without any action.

Timeline of NAPSLO Activity

- SLIMA Proposed and Adopted: October 2010. Florida proposed SLIMA, which ultimately was renamed NIMA. It is subsequently adopted a few days after its proposal. It contained the following language with respect to allocation.

  For purposes of determining how the premium charged for a specific risk will be allocated by the broker among the Participating States, the tax payable to each state shall be computed on the portion of premium attributable to the exposure located in each state based on the rating basis used to determine the premium for the particular policy.

  In the event that the use of the rating basis is not practical, another equitable apportionment may be used provided it is adequately described on the allocation worksheet. Brokers must consistently apply the formula or methodology utilized across similar types of insurance policies and must maintain for a period of five years the worksheet used to determine the premium allocation

- NIMA Allocation Formula Proposed: November – December 2010. Alaska Insurance Commissioner Hall was assigned the task of offering an initial allocation proposal, which she presented at the NAIC Surplus Lines Task Force Meeting in November. This was the first unveiling of the tax allocation proposal that evolved in to what has been attached to NIMA ever since. At the meeting, the industry had its first opportunity to discuss allocation with Task Force leaders. NAPSLO Legislative Co-Chair and Executive Vice President and Director of The Sullivan Group, Hank Haldeman spoke frankly about the problems of the proposed NIMA allocation formula, and explained that it contained many unworkable allocation bases. The NAIC offered no immediate response but noted that the problems Haldeman raised would be taken under consideration and that the proposal was not final. In December, a detailed version of the allocation method was attached to the NIMA draft. NAPSLO's submitted written comments were not discussed at the December 1st teleconference.

- December 3, 2010 Brokers Letter

  Because there was no discussion of allocation during the December 1st meeting, some brokers submitted a letter to Commissioner Donelon and the NAIC Surplus Lines Task Force on December 3rd, clearly explained the problems the NIMA formula would create for insureds as well as brokers, and requested that the Surplus Lines Task Force develop an allocation approach "in active discussion with the brokers that handle the specific types of coverage involved."

- December 10, 2010 Task Force Meeting

  This was, essentially, the final organizing/drafting meeting for NIMA. The Brokers Letter was attached to the meeting materials, and NAPSLO was given an opportunity to comment. NAPSLO member brokers emphasized the industry concerns with the NIMA formula again. At that meeting, and consistently from that point forward, NAPSLO has stated the proposed NIMA allocation approach is unworkable and inconsistent with the intent of the federal surplus lines reforms. No further discussion, or opportunity to discuss, took place until the March 2011 meetings.

- <u>March 2011 NAIC Meetings</u>

  At the Spring Meeting of the NAIC in early March NAPSLO and other industry stakeholders renewed their stance on the allocation scheme. Though there appeared to be some direction towards revising the allocation methodology, no action followed.

- <u>Broker Reaction Document to NIMA Allocation – early April, 2011</u>

  In early April, NAPSLO released the short survey of broker feedback on the NIMA allocation approach, detailing myriad issues. This document is attached as Exhibit 3. This document was provided to the NAIC Surplus Lines Task Force members, state legislatures considering NIMA, and to other stakeholders.

  In early April, NAIC Surplus Lines Task Force representatives assured industry representatives that the Task Force would consider some modification to the NIMA tax allocation methodology. In late April, Task Force representatives suggested that it was "too late" to consider modifications to the NIMA methodology.

  Things again went silent until NAPSLO requested a meeting in Washington, D.C. with NAIC staff.

- <u>NAPSLO Meeting with NAIC Staff – May 12, 2011</u>

  NAPSLO met with NAIC staff to again articulate industry's concerns with the NIMA methodology. NAIC staff was receptive, and seemed willing to consider the request for a formal opportunity, (e.g. a task force or committee or advisory group) to bring NIMA proponents and industry together to fix the allocation methodology. During this meeting, NAPSLO also offered two potential approaches as the basis for discussion.

  From May through June, NAPSLO had various conversations with NAIC staff and Commissioner Donelon and there appeared to be a commitment to address allocation, but never any action.

- <u>NAPSLO Call with Commissioner Donelon – July 11, 2011</u>

  During this short call, a NAPSLO member and representatives spoke with Commissioner Donelon and NAIC staff about the proposed Schedule T allocation approach. Commissioner Donelon indicated a willingness to consider changes to the NIMA methodology, but questioned whether such would be possible without legislative changes to NIMA state statutes. Later Commissioner Donelon suggested an alternative exposure-based approach, like Kentucky's proposal, would be more likely to be successful with NIMA states. NAPSLO has since agreed to compromise and support the Kentucky approach, even though the Schedule T approach is still preferred. NAPSLO has communicated our position to the NAIC and certain NIMA states; we await some action.

This recitation of facts is intended to explain NAPSLO's frustration with the NAIC and NIMA' states, who refuse to seriously consider any proposal to amend the convoluted and unworkable NIMA tax allocation system. In our view, their actions betray Congress's efforts to streamline the surplus lines regulatory system. We applaud this Committee's work in passing the *Nonadmitted and Reinsurance Reform Act* as part of the *Dodd-Frank Act*, and hope that the NAIC and NIMA states will soon show some respect of Congress' intentions by taking action to amend their tax allocation methodology.

Opportunity for Improvement

NAPSLO continues to urge the NAIC to amend NIMA's tax allocation methodology to provide a simple, efficient, and equitable means of tax allocation. While we favor using market-share as the basis for tax allocation, NAPSLO has been impressed by the work of Kentucky's Insurance Commissioner, Sharon Clark, and her formula to allocate taxes based exposures. In our view, Kentucky's tax allocation formula presents a workable compromise that would be a vast improvement over the NAIC-NIMA tax methodology currently envisioned. NAPSLO strongly urges all parties to abandon the NIMA tax allocation methodology and instead adopt a formula like the "Schedule T" methodology or Kentucky's exposure-based approach.

It may be that Kentucky's proposal is the most viable option to immediately remedy the most onerous aspect of the NAIC-NIMA approach. While we have heard that some NAIC and NIMA state leaders are amenable to the Kentucky approach, to date we have seen no tangible action from them to advance this option. Indeed, just the opposite is occurring -- certain NIMA states have already moved ahead with NIMA using the original burdensome, complex exposure-based methodology.

Conclusion

In conclusion, NAPSLO hopes today's hearing will

- shed further light on the problems of NIMA – especially its current tax allocation methodology;
- remind the NAIC and NIMA state leaders about the NRRA's purpose which was to create a more simple, efficient and uniform system of surplus lines regulation for the benefit of all stakeholders; and
- inspire the NAIC and NIMA state leaders to abandon their currently convoluted and burdensome tax allocation methodology, and replace it with Kentucky is reasonable, workable compromise approach, or a "Schedule T" like methodology.

Again, I thank the Committee, its leadership and staff for the opportunity to testify at this important hearing.

Exhibit 1

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Differentiating characteristics of SLIMPACT-Lite and NIMA

Overview
Congress passed the *Nonadmitted and Reinsurance Reform Act* (NRRA) as part of the *Wall Street Reform and Consumer Protection Act* which was signed into law on July 21, 2010.

The NRRA seeks to, "streamline the regulatory regime to enable insurers and brokers to more easily and efficiently comply with state rules and provide much-needed insurance protection to consumers." - *The Honorable Dennis Moore (D-KS), Primary sponsor of NRRA, December 15, 2010 – Federal Register.*

In the wake of NRRA's passage, two approaches for implementing the NRRA have prevailed at the state level – Surplus Lines Insurance Multistate Compliance Compact ("SLIMPACT-Lite") and the Nonadmitted Insurance Multistate Agreement ("NIMA"). The following is a brief overview of the two competing approaches.

Side-by-Side Comparison

Provision	SLIMPACT-Lite	NIMA
Origins	Drafted by over 60 industry representatives, brokers and trade associations with input from regulators and legislators.	Drafting began in the Fall of 2010 by an NAIC working group of 12, comprised mostly of state insurance department staff.
Scope	Drafted to create an efficient tax allocation system for brokers **and** to develop uniform standards to modernize and streamline state-by-state standards and processes.	Addresses tax treatment only. Does not attempt to address the NRRA's call for a more uniform standards and processes.
Design Structure	An interstate compact which provides legal means for states to jointly regulate in a uniform manner. Compacts were expressly referenced in NRRA.	A proposed contract, not a compact. It is intended that state legislatures will authorize states to enter the agreement with other states or a clearinghouse that has yet to be created.
Governing Structure	Includes a Commission whose members are chosen by the States, an Executive Committee as a governing board, and an Operations Committee. The structure is patterned after the IIPRC.	Includes no consideration of a governing structure.

Tax Collection	Each state must limit tax collection to *no more than* four specific dates a year with the option of annual, semiannual or quarterly collection.	Requires all states to convert to quarterly tax returns.
Tax Rate	Each state is permitted to establish one single rate of taxation to apply to nonadmitted insurance transactions.	Similar to SLIMPACT-Lite but subject to change.
Tax Allocation Methodology	Not yet finalized, but the SLIMPACT guiding principles note that, "*allocation formulas will be established with input from Surplus lines Licensees and be based upon readily available data with simplicity and uniformity for the Surplus Line Licensee as a material consideration.*"	Current version is highly complex, burdensome, and unworkable for the industry as it involves dozens of different allocation formulas and requires a minimum of between 30 and 80 data elements per policy, for both property and casualty lines.
Solvency & Eligibility	Includes authority to set national insurer solvency/eligibility standards. NRRA prohibits most state-specific eligibility standards but authorizes the adoption of national uniform eligibility standards through a compact or similar mechanism.	No similar provisions. As a result, states may have limited authority to impose solvency oversight on insurers writing surplus lines business.
Establishment of Clearinghouse	10 states of states must enact the compact before it can create a clearinghouse and adopt uniform rules.	2 states can agree by contract and establish the clearinghouse and plan of operations.
Industry Endorsements	Endorsed by NAPSLO, AAMGA, CIAB, RIMS, PCI, NCOIL, NCSL, CSG, numerous state stamping offices and other insurance trade associations.	Adopted by the NAIC and is largely opposed by industry.

Conclusion

NIMA is inconsistent with the NRRA and therefore should not be adopted by states.

1. NIMA fails to implement the efficient system or uniformity required by the NRRA.
2. NIMA violates the NRRA requirement that "no state other than the home state . . . may require any premium tax payments for nonadmitted insurance."
3. NIMA involves unnecessary and burdensome data reporting by brokers for the sole purpose of collecting taxes, including novel allocation requirements for casualty lines.

Exhibit 2

RICHARD A. BROWN
ATTORNEY-AT-LAW

ANALYSIS OF THE NONADMITTED INSURANCE MULTI-STATE AGREEMENT (NIMA)[1]

May 11, 2011

The National Association of Insurance Commissioners (NAIC) has proposed that the States enter into a multi-party contract – The Nonadmitted Insurance Multi-State Agreement (NIMA) – pursuant to Section 521(b)(1) of the Nonadmitted and Reinsurance Reform Act of 2010 (NRRA). The NAIC has also has released a draft "Nonadmitted Insurance Premium Tax Clearinghouse Access Agreement" ("Clearinghouse Contract") between the "Clearinghouse" and Participating States[2].

The purpose of the NRRA is to simplify and streamline regulation and taxation of surplus lines insurance transactions. Effective July 21, 2011, the NRRA establishes Home State taxation whereby each surplus lines transaction may be taxed and regulated only by the "Home State." Section 521(a). The NRRA preempts state law to eliminate the multistate taxation and regulatory system that has subjected surplus lines brokers to costly and burdensome compliance with conflicting state taxation and regulatory filing requirements for policies that insure risks in more than one state.

The purpose of NIMA, in contrast, is to replicate and preserve via a "Clearinghouse" substantially the same system of multistate taxation that Congress sought to eliminate through creation of Home State taxation under the NRRA.

This paper reviews certain major issues presented by NIMA and the Clearinghouse Contract.[3]

A. Overview

- The NIMA Clearinghouse venture is inherently unstable.

  In any year some Participating States will be Clearinghouse winners and other States will be Clearinghouse losers. The losers will quickly give sixty days notice of termination and exit NIMA. Larger surplus lines states that believe they will benefit from Home State taxation will not join.

- NIMA is incomplete, its terms vague, and its enforceability highly doubtful. The data do not exist that would allow comparison of the premium tax revenue consequences of NIMA and the Clearinghouse with (a) historical premium tax revenues or (b) the effects of

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[1] This paper has been commissioned by the National Association of Professional Surplus Lines Offices (NAPSLO). The author is a recognized expert on the NRRA who has written multiple articles about the NRRA and related state implementing legislation. Copies of those articles can be found at www.InsuRegulatory.com and www.InsuranceJournal.com.

[2] Unless otherwise noted, section references are to the NRRA; paragraph references are to NIMA or the Clearinghouse Contract as the context indicates.

[3] NIMA's "Exposure Allocation Methodology" and specific data reporting requirements are beyond the scope of this paper.

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Home State taxation. NIMA's dispute resolution provisions lack standards or criteria for measuring a Participating State's right to compensation in the event of a dispute.

- The Clearinghouse has no governance structure and the NAIC's role in Clearinghouse governance is undefined. There is no timeline for the Clearinghouse to become operational, no budget, and no financial projections.
- NIMA fundamentally conflicts with the NRRA.
- NIMA presents insurmountable compliance obstacles for surplus lines brokers. NIMA's membership and tax rates can change at any time with little or no notice. When that occurs, the surplus lines broker is forced to reprogram accounting and data processing systems to take account of extraordinary premium allocation and tax rate calculation complexities depending on (a) whether taxes are paid and filings made directly to the Home State or (b) to the Clearinghouse.
- The NAIC describes NIMA as a "multistate agreement," a legally untested approach to an interstate pact that does not satisfy the requirements of an "interstate compact" within the meaning of Article I, Section 10 of the United States Constitution.
- NIMA and its Clearinghouse are subject to inevitable challenge on numerous legal grounds that likely will engage Participating States in litigation for years.

B. NIMA Background

At the NAIC Summer Annual Meeting in August 2010, the NAIC Executive Committee charged a "Surplus Lines Implementation Task Force" with development of state-based solutions for implementation of the surplus lines provisions of the NRRA.

The Task Force determined that the best solution was to create an "interstate agreement" that provides "a means for preserving something close to the status quo where premium taxes are concerned."[4] The status quo is the multistate surplus lines taxation system that Congress enacted the NRRA to eliminate.

The Task Force appointed a subgroup to be responsible for developing a Clearinghouse plan of operation and for identifying third-party vendors with the software and other capabilities to operate the Clearinghouse.

NIMA itself consists of an eight page form of contract accompanied by eight pages of "Annexes" that specify how surplus lines premium is to be allocated for multistate risks. The NAIC is not a party to NIMA or the Clearinghouse Contract, or mentioned in either document.

When the NAIC Executive Committee "approved" NIMA in December 2010, NIMA was not in final form. The Executive Committee has not yet "approved" the Clearinghouse Contract. NIMA remains a working draft in the early stages that posits only a general framework for

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[4] NAIC Initiatives Non-Admitted and Reinsurance Reform Act of 2010 (NRRA): Surplus Lines (www.naic.org)

establishing a Clearinghouse and procedures for receipt and redistribution of surplus lines tax among Participating States.

C. Inherent Instability

Each Participating State necessarily exposes its treasury to reduction by the amounts of Home State surplus lines tax revenues that the Clearinghouse may allocate to other Participating States. On sixty days notice a Participating State can terminate under NIMA to cut its losses or bank its winnings, as the case may be (¶ 26(a)).

NIMA's only requirement to rejoin the Clearinghouse is "renewed execution of the Agreement."

NIMA's sixty-day termination notice provision underscores the fact that states are unwilling to make a long-term commitment to NIMA and the Clearinghouse. Once a Participating State sees that it is sending premium tax revenues to other Participating States or that its Clearinghouse allocation is less than the premium taxes it would have received as the Home State, the Participating State will terminate. That cycle will naturally repeat itself until NIMA collapses.

Larger states like New York and California that are the principal place of business for many large national and multi-national businesses, and therefore expect to benefit from Home State taxation, have declined to participate in NIMA. After the NRRA takes effect on July 21, 2011, states have no apparent incentive to share their Home State tax revenues with sister states.

Under the pre-NRRA system, there have been no uniform rules for allocation of surplus lines premium tax. Surplus lines brokers therefore have allocated premium for multistate risks based largely on the broker's professional judgment and industry convention. Accordingly, there are no data showing the premium tax effects of any given allocation methodology. It therefore is impossible to determine how NIMA's premium allocation methodologies will affect the premium tax revenues of any Participating State.

Similarly, it will be some time before there are reliable data to compare whether a Participating State's share of Clearinghouse tax collections are greater or less, after consideration of Clearinghouse transactional costs, than what a Participating State would have received under Home State taxation. Until reliable Home State taxation data are available, it is impossible for a state to measure the effects of NIMA and the Clearinghouse on its surplus lines premium tax revenues.

NIMA's dispute resolution provisions provide no standards or criteria to measure damages for a breach of NIMA and require mediation before a Participating State may initiate arbitration or litigation. Resolution of disputes between and among Participating States, the Clearinghouse, and the NAIC will be protracted and necessarily disrupt receipt of tax revenues by Participating States for years. NIMA provides no alternative dispute resolution remedies for surplus lines brokers forced to use the Clearinghouse.

Legal challenges on numerous grounds will embroil Participating States, as well as the NAIC, in protracted litigation that also can be expected to disrupt Participating States' receipt of tax revenues for years.

D. Uncertain Governance

NIMA's governance provisions are Spartan.

NIMA becomes effective upon execution by two or more Participating States, two-thirds may amend it in writing (¶ 25), and the Clearinghouse will operate "pursuant to a plan of operation, to be agreed by two-thirds of the Participating States" (¶ 10). As a practical matter, once a plan of operation is approved by the first two Participating States, the two-thirds amendment requirement will make it difficult if not impossible for subsequent Participating States to modify NIMA.

NIMA provides that "each Participating State agrees to require, by statute or rule" that surplus lines brokers remit surplus lines premium taxes to the Clearinghouse (¶ 17). NIMA therefore would bypass state legislative and administrative rulemaking requirements concerning matters such as the Clearinghouse's authority to demand data and to conduct premium audits.

The Clearinghouse Contract provides: "The State is represented by the state agency or agencies charged with enforcing State laws and regulations relating to Nonadmitted Insurance premium taxes." (Recitals, ¶ B). Many states therefore would be represented by at least two agencies, the department of insurance and the state agency responsible for premium tax collection and enforcement.

NIMA and the Clearinghouse Contract are silent regarding whether the Clearinghouse will be a corporation, a partnership, or some other form of business or nonprofit enterprise.

NIMA and the Clearinghouse Contract offer no governance or advisory role for surplus lines brokers and other affected parties.

E. NRRA Conflicts

NIMA fundamentally conflicts with the NRRA.

First, NIMA conflicts with the NRRA's principal purpose, which is to simplify and streamline regulation and taxation of multistate surplus lines transactions.

Second, NIMA redefines certain NRRA's terms and adds terms that would restrict and undermine the NRRA.

1. <u>Home State</u>

Home State is generally defined by the NRRA to mean the state of the insured's "principal place of business" or "principal residence." The NRRA, however, does not define "principal place of business." Relying on a recent U.S. Supreme Court decision, Friend v. Hertz, __U.S. __, 130 S. Ct. 1181 (2010), a case involving the "diversity-of-citizenship" jurisdiction of the federal trial courts, NIMA defines "principal place of business" in a way that leaves the term Home State open to multiple interpretations certain to confuse both licensees and premium auditors.

To determine Home State under the NIMA principal place of business definition, the surplus lines broker is required to verify (a) where the insured maintains its headquarters, (b) where the insured's "high-level officers direct, control, and coordinate its business activities,"

(c) whether they do so in more than one state, and (d) whether the headquarters are located or the "high-level officers direct, control, and coordinate its business activities" outside any State."

"Principal place of business" is a legal term of art that has been the subject of hundreds of federal court decisions over the years. The easy cases obviously are not litigated. Those that are litigated are highly fact-sensitive. It is legal folly for NIMA to attempt a "one size fits all" definition of principal place of business, particularly in the untested arena of NRRA preemption.

2. <u>Group Insurance</u>

NIMA defines the Home State for "Group Insurance" to be each state where a group member pays any portion of the premium from his, her, or its own funds; in other words, multiple Home States. The NRRA provides that there shall a single Home State; the term Group Insurance does not appear in the NRRA.

The Group Insurance definition of Home State under NIMA directly conflicts with the NRRA and would eviscerate many group insurance programs by making them cost-prohibitive due to the transactional costs involved with multiple state tax and regulatory filing requirements.

3. <u>Surplus Lines Insurer Eligibility</u>

Although NIMA does not address surplus lines insurer eligibility directly, it does so indirectly:

> "Surplus Lines Insurer" means a Nonadmitted Insurer permitted ***<u>under the law of the Home State</u>*** to accept business from a Surplus Lines Licensee. [¶ 5.n.]

The NRRA preempts state law to set uniform national standards for surplus lines eligibility. Provided that the nonadmitted insurer satisfies Home State minimum capital and surplus requirements ***<u>or</u>*** is listed on the NAIC Quarterly Listing of Alien Insurers, a state ***<u>may not prohibit</u>*** a surplus lines broker from placing insurance with a nonadmitted insurer. Section 524.

F. Compliance Impossible

Each time a Participating State joins or exits NIMA, surplus line broker agent management and accounting systems must be reprogrammed with new premium tax rates and premium allocation formulas to comply with NIMA or the Home State's rules, as the case may be. Compliance and training procedures similarly must be updated.

- NIMA allows Participating States to exit on sixty days notice and re-join at any time simply by re-executing NIMA.
- Participating States must give ninety days notice of changes to their premium tax rates and statewide assessments. However, the effective date for the change need not coincide with a calendar quarter or any other normal accounting period.
- The surplus lines broker may be required in some cases to determine premium tax differently depending on whether premium allocations for non-Home State exposures involved Participating States.

- NIMA and the Clearinghouse Contract require no notice to surplus line brokers about changes in NIMA membership or changes in Clearinghouse tax rates, fees, or procedures.

There are a virtually infinite number of programming variables associated with Participating States (a) exiting NIMA on sixty days notice to rejoin whenever they wish, and (b) ever-changing tax rates and statewide assessments with inconsistent effective dates. Simultaneous compliance with Home State law for non-NIMA states introduces yet another complex set of programming variables. Combined with the NIMA/Clearinghouse lack of notice requirements, compliance is impossible.

Many surplus lines brokers contract with one of several major data processing vendors for access to an "agency management system" that tracks policy information, premium allocations, and other transactional data. Major programming changes can require a consensus of representatives of perhaps hundreds of users. Once major programming changes are agreed, it can take months or longer for the programming to be completed, tested, and implemented.

NIMA and the Clearinghouse are the antithesis of the nationwide uniformity intended by Congress. Instead of simplicity, the NIMA/Clearinghouse venture would subject surplus lines brokers to compliance requirements considerably more complex, cumbersome, and costly than the multistate taxation system in effect prior to July 21, 2011.

G. Compact Considerations

NRRA Section 521 provides:

(a) Home State's Exclusive Authority. – No State other than the home State of an insured may require any premium tax payment for nonadmitted insurance.

(b) Allocation Of Nonadmitted Premium Taxes. –

(1) In General. – 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*** described in subsection (a).

***

(4) Nationwide System. – The Congress intends that each State adopt ***nationwide uniform requirements,*** forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for Nonadmitted insurance ***consistent with this section.***

The NRRA provides that surplus lines brokers shall pay surplus lines premium tax only to the Home State. Congress leaves to the States how to allocate such premium tax receipts among themselves. There is no suggestion in the NRRA that two or more States may ***contract*** to require surplus lines brokers to remit surplus lines premium tax ***other than to the Home State.***

The co-author of a treatise on interstate compacts and leading authority on the topic has opined that NIMA does not satisfy the requirements for an interstate compact because it (a) "fails to provide a binding agreement which pre-empts other state laws n conflict with its requirements,"

and (b) "unconstitutionally purports to vest authority in an Executive Branch official (e.g., the Insurance Commissioner) to bind the Legislature of a State which adopts it."[5]

H. Legal Challenges

NIMA and the Clearinghouse Contract are subject to legal challenge on a number of grounds, including:

- NIMA fundamentally conflicts with the NRRA.
- NIMA is unenforceable due to omission of contract terms essential for a "meeting of the minds" among Participating States.
- The NAIC has failed to disclose material information such as financial projections, a plan of operation, and the NAIC's role with the Clearinghouse and its governance.
- NIMA requires unlawful delegation of legislative authority to one or more state agencies.
- NIMA and the Clearinghouse Contract fail to comply with state government contract requirements. They also would violate state administrative procedure act and "Sunshine" laws, thereby denying Due Process to surplus lines brokers, potential bidders seeking to provide Clearinghouse services, and other affected parties.
- NIMA is subject to potential antitrust scrutiny under Section 541[6] in connection with the NAIC and Task Force roles in establishing and controlling the Clearinghouse, and arguably otherwise attempting to restrain trade and commerce.

I. Conclusion

NIMA is incomplete and ill-conceived. The Clearinghouse is ill-defined and far from becoming operational.

NIMA is essentially a game of chance for Participating States where the losers will quickly leave the table, an inevitable recurring cycle.

Standing alone, the purported economic benefit from participation in the Clearinghouse is illusory. Absent reliable data, a Participating State cannot determine the comparative amounts of surplus lines premium tax revenues it would receive as Home State free and clear of Clearinghouse transaction costs, leaving aside exposure to unquantifiable potential liabilities.

NIMA and the Clearinghouse would impose intolerable compliance costs on surplus lines brokers and increase the cost of insurance with no benefit to surplus lines insurance buyers or measurable benefit to Participating States' treasuries.

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5 Letter from Rick Masters, Special Counsel for Interstate Compacts, to NCOIL, NCSL, and CSG (January 26, 2010). A copy can be found on the website of the Council of State Governments (www.csg.org).

6 "Nothing in this subtitle or the amendments made by this subtitle shall be construed to modify, impair, or supersede the application of the antitrust laws. Any implied or actual conflict between this subtitle and any amendments to this subtitle and the antitrust laws shall be resolved in favor of the operation of the antitrust laws."

Home State taxation under the NRRA is a straightforward solution for the confusing and conflicting multistate surplus lines tax system that has burdened the surplus lines industry for decades. If and to the extent that Home State taxation should adversely affect premium tax revenues of certain states, the issue can be addressed directly with Congress or through an interstate compact.

NIMA with its inherent instability cannot solve the problem.

Exhibit 3

Surplus Line Broker Observations on the Implementation of NIMA's Allocation Methodology

April 10, 2011

The following is compiled only as a sampling of the kinds of problems and issues Surplus Line Brokers perceive in implementing the Allocation Methodology included in NIMA. It is not a comprehensive review and commentary on the allocation basis proposed for each coverage.

A copy of the Allocation Methodology included in NIMA was circulated to eleven wholesale Surplus Line Broker firms to comment generally on the feasibility of implementing the methodology. The following, immediate responses were received. All are direct quotes. Additional information on the process follows at the end.

Comments on Specific Allocation Proposals

The following comments were made by brokers actually handling the specific type of risk upon first review of the NIMA Allocation Methodology:

Directors & Officers Liability

Proposal: Allocate by "Revenue Generated" in each state

- "It [allocate premium by revenue generated in each state] would potentially be a challenge and problem for the insureds. First of all, D&O insurance is based on many factors, and specifically assets, but revenues too are considered. However, the underwriting is based on consolidated financials, meaning the revenues and/or assets of the company are *not broken down by State*. It's possible the insureds would have such information, but it would be a pretty big burden for them to collect all the data from their various states/divisions etc. I could envision receiving material push back from retailers, and then frustration pushback by the insureds. Most of our insureds are privately held companies or non profit companies. They are not going to have the accounting staff or necessary resources to be able to provide this information."

- "Publicly traded entities are the only Insured's that I have worked with that track business activities by state. Most of the business that we handle are not publicly traded or are non-profit. The Insured's would not track this information."

- "Current applications do not capture this data. Revenue per state has nothing to do with the pricing of this exposure. Revenue in any given state has nothing to do with where a claim may be brought on this coverage.

Directors & Officers Liability, SEC Liability, EPLI, Professional Liability/E & O, Patent Infringement and Intellectual Property

Proposal: Allocate by "Revenue Generated," "Headcount," or "Number of Professionals"

- “Revenues or headcount by state is not typically a part of the underwriting criteria requested, therefore additional burden is placed on the broker, agent and insured to develop information not part of the insuring process. This may also force some insured’s into creating additional procedures to capture this information.”

Professional Liability

Proposal: Allocate by Revenues (receipts) or Number of Professionals in each state

- “In the case of say professional liability, it is not uncommon for a professional to practice in both states, how does one allocate on the basis of number of professionals per state as proposed? Ultimately this would come back to the insured who may or may not track this on the basis proposed.”

Professional Liability (Managed Care E&O)

Proposal: Allocate by Revenues (receipts) or Number of Professionals in each state

- “The breakout of applicant’s/Insured’s business activity information by state is not included as a standard underwriting question, meaning that the submission material received does not provide this breakout. I believe this information would be arduous for the Insured to provide as most professional liability activities are performed under contract with the third party client and the revenue would be aggregated by client but not necessarily within the state in which the business activities were conducted. “

General Liability, Excess Liability & Umbrella Liability (All Operations)

Proposal: Allocate by Payroll, Square Footage, Cost of Contract, Sales, Receipts, Number of Events, et al., depending on the specific operation

- “Because these coverages often contain combinations of a multitude of exposures, breaking out premiums in this degree of detail would generate a tax filing process *more time consuming and onerous than the entire placement process of the account combined*. Also, certain exposures are co-mingled such as Premises Operations & Manufacturers & Contractors or Products and Completed Operations. Insured’s would not track separate information between Products & Completed Operations or Contractual.”

General Liability: Products Liability

Proposal: Allocate by Sales in each state

- “For instance when a product is manufactured and then distributed in multiple states, it is impossible to determine if that product has actually been used in the state distributed or some other state. [Our firm] exists in a city whose metro area is spread over two states. Product moves freely from state to state...how would we determine where the exposure is located?”

- “While the applicant may, after great effort, discover an estimation of revenue by state, there is no correlation to the coverage, pricing, nor potential claims based on that initial segmentation. And revenue in their local state by them will have no bearing on the use of their products by state, as those products migrate across state lines. Where they sell the product wholesale, seldom has any correlation to where the product is used, after retail sales.”

Umbrella Liability

Proposal: Allocate in each state, depending on type of operation insured

- “True umbrella deals with rating for GL, Fire Legal, Transportation, and many other coverages – all of which are rated differently. Where payroll or gross receipts occur in the primary coverage rating, does not match the exposure, and therefore the premium generated. Using the primary rating breakdown is not possible, as the umbrella carrier does not necessarily write any primary policies. Therefore, all such rating materials would have to be collected again, making the rating/submission process doubly difficult for the insured, retailer, wholesaler, and market. “

- “Umbrella liability provides excess limits for a combination of coverages, including not only General Liability, but also Auto Liability, Employers Liability and Advertising Liability, and may include excess Professional Liability or D&O coverage. Allocating based on the principal GL exposure might be possible with respect to some of our insureds but often would be completely unrepresentative of the risk. It makes little sense to allocate most Umbrella anywhere other than the home office of the insured.”

Railroad Protective

Proposal: Allocate by “Miles of Track” in each state

- “Miles of Track in each state is not a part of underwriting criteria and therefore creates development of additional information not relative to insuring process.”

Inland Marine

Proposal: Allocate by TIV in each state

- “Inland marine [is] by [its] very definition is transient. How do we determine where the equipment is and for how long?”

General Liability & Property (Apartment Houses)

Proposal: Allocate property by TIV and liability by square footage in each state

- “Property and Liability for Apartment houses may actually be rated on number of doors. TIV does not tell the story for allocation. The value of an apartment building is vastly different per square foot in California versus Oklahoma however the exposure for most perils is significantly more hazardous in Oklahoma excluding EQ of course.”

General Liability (Special Events)

Proposal: Allocate by “Number of Events” in each state

- “Number of Events in each state is not indicative of the exposure basis by state. (Some events may be small and others much larger.)”

- “Rating may be based on admissions, or may be flat. In either case, number of events in each state is not presently tracked for insurance purposes. In fact, the number of events is unlikely to be known, or even estimated, at the time coverage is placed.”

Media Liability

Proposal: Allocate by TIV in each state

- “TIV is not relevant to the exposure on this coverage, by state or otherwise. While certain media coverages do include physical damage to media property, the exposure to liability is not relative to TIV.”

- “This makes no sense: Media Liability primarily insures against defamation and invasion of privacy claims as well as copyright and/or trademark infringement. There are no “values” to be tallied for TIV! Coverage is bought by publishers for printed (and electronic materials) published by them; by film and TV producers for their productions; by advertisers for their advertising content, etc. There is no consistent way to allocate this. Consider a book publisher protected by media liability. The exposure arises from every book sold, but perhaps years after that book has been sold…and there is no way for a publisher to track where its books are being sold.”

Marine

Proposal: Allocate by TIV or "Principal Berthing Location" in each state

- "By nature this is a mobile exposure often located in various states at different times."

Property

Proposal: Allocate by TIV in each state

- "In the cases where all properties are scheduled, with values assigned to specific property locations, THEN the taxation and policy limits CAN match. However, anytime a "blanket theory" is used on property, then the policy values would NOT be used, and the policy would need a declared RATING value for the schedule of properties, by state, to be provided. As the RATING value changed over time with endorsements, the tax allocation would follow. Samples follow:

Scheduled Buildings

NY: 4,500,000 Premium: $9,000
NJ: 10,000,000 Premium: 10,000
MN: 16,000,000 Premium: 8,000

TIV: 30.5mil total values, allocate the premium based on RATES CHARGED BY LOCATION, rather than as a percent of the total premium based on percent of TIV in that particular state. In this case, we all know (insured, retailer, wholesaler, carrier, reinsurer) just how much premium was charged for every state.

Blanket Concepts

NY: 30,500,000 blanket Premium: $27,000
NJ: included
MN: included

30.5mil total values, same total premium, but how much value is allocated by state is impossible – the very POINT OF BLANKET coverage. The policy will have a "blended" rate to be used during the term ($0.0885245 per 100 value). Inside the carrier pricing, though no value per location can be determined on the policy, they know that they RATED THIS RISK using the values of 4.5, 10, and 16mil allocated by the states. Therefore, multiply those ESTIMATED VALUES USED FOR RATING times the POLICY RATE, to get per state premium allocations.

These two samples, though using the same apparent values and premiums, will not allocate the same, because the blanket theory is involved, allowing the insured to use whatever portion of the limit they need at the time of the loss (subject to contract terms). This is the point of having such contract terms be available, and the taxation collection issues should not serve to inhibit these terms of advantage to the insureds. Instead, state taxation assignment should be given as simple a mechanic as possible, to

not inhibit trade, practice, operation, or coverage ability of the insureds nor the industry providing those options."

General Comments

- "I have reviewed the allocation basis being proposed by NIMA and would find it problematic for [our firm] to comply and continue to adequately serve our customer base. State of domicile for most GL, Excess and Umbrella coverage make sense and have been the norm for many years.

This applies really to almost all third party coverage. [Examples, for Products Liability and Professional Liability included above.]

Ultimately this would come back to the insured who may or may not track this on the basis proposed."

- "It would be very difficult to separate these exposures by state. Primarily we would have to rely solely on our retail agent and insured to provide this information at quoting / binding. Many of these exposure bases are a moving target, ie # of staff members per state, headcount per state. This would vary during the policy period and would be a nightmare at audit to go back and recalculate the actual premium and then determine what the original premium / taxes were based on. The cost involved to manually calculate many of these exposures by state would be cost prohibitive and would in fact cause some brokers to not even look at multi state accounts because the paperwork involved to handle this sort of undertaking."

- "Tax filings will be slowed down by this onerous a process, and to avoid creating an additional burden for the insureds, information will be "guesstimated" and not accurate."

- "According to our SL tax filing staff, this complex a reporting procedure will force wholesalers and/or retailers to add staff for the purposes of filing documents."

- "Multi-National Accounts—Often, policies contain exposures outside the US. Would these premiums/exposures be exempt from SL taxes since they cannot be allocated by state? For liability exposures, taxes go to the US state of domicile."

- Multi-state Package Policy: "One of our biggest insureds bought another operation in Oklahoma and in Florida during the policy period. Not only did we have General Liability, we also had property coverage, umbella and cargo coverage all written on a non admitted basis. Trying to determine the additional premium [separately] for Oklahoma and Florida [would be] very difficult. The insured and our agent [would] not understand why it was necessary to split out the information, payroll and receipts for each state."

- "One of our insured's purchased a business in Mississippi so it was necessary to endorse our Texas policy to provide coverage for the new location. The operation in MS was small so the additional premium to add the new location was small. However, sometime during the policy term, the insured

decided to move most of his main operation to MS due to the cost of living. We had to go back rerate the entire policy and return tax to Texas and charge more MS tax on the new exposure basis of the new payroll and receipts. It was very difficult for the insured to provide us with exact effective dates as to when each employee moved from Texas to MS. Therefore, this created an enormous amount of paperwork on the insured and of course they do not understand why it is necessary to break the employees, payroll and receipts by each location."

- "Attached please find a collection of applications used in our brokerage business for a wide variety of risks.* You will note that not a single one breaks out revenue or head count by state.

Also attached are some rating worksheets for our GL program business, one for Fire suppression, one for Security Guards and one for Janitorial companies. These sheets demonstrate the fact that carriers are not presently using any state by state detail for rating purposes.

The bottom line is that many insureds will not have the information contemplated by the allocation method proposed by NIMA. Most insured's will not necessarily capture data in this fashion.
The reporting proposed by the NAIC (NIMA) places an additional and undue burden on insureds. The applications and rating worksheets confirm that the information sought by the NAIC/NIMA is not presently provided nor is it presently requested of the consumer. The commissioners will be placing undue burden and expense on the very constituency they are obliged to protect by asking them to gather this additional detail to present to their agents in order to obtain coverage.

The carriers themselves rate coverage on a class basis not on a state basis. Therefore, the sole purpose of this request for additional information will be to provide information for tax allocation. The data itself provides no utility in the insurance transaction other than to indicate tax allocation. Indeed this is contrary to the spirit of the NRRA."

- "Like a state income tax can be levied on a company that does business all over the country, at the choice of the resident home state, so too should a premium tax follow on exact theory, without allocation to other states. The only exception may be REAL PROPERTY – not including inland marine that serves for the good of transportation, and generally or frequently crosses state lines in a manner that cannot be tracked without an onerous system of state border checks. In the case of real property, it is something that all parties to the insurance transaction can agree, already track, and can easily be reported. And since the state systems serve real property in similar relation to their values, it is a fair system, however, the states involved must have the understanding that INSURANCE LIMITS are not the same as STATE VALUES. Because there is the theory of "blanket" limits within insurance policies, but those limits seldom match the estimated values, and the very point of this theory is to allow such a mis-match, then the states would need to accept "rated estimation" values, rather than "scheduled policy" values."

Background

The responding firms represented a cross-section of smaller, regional and national wholesale brokers. Within two working days, response had been received from seven. One indicated that the nature of its business was such that it really would not be impacted and a second noted that, due to the nature of risks written, they would need substantial, costly changes to their systems to collect and submit the information required.

No attempt was made to obtain response on each of the specific allocation bases. Instead, the purpose was to provide a quick sampling, with comments limited to impact on specific business actually handled by the firm. If a methodology as has been proposed is to be used, input should be obtained for each type of risk from wholesalers that actually handle each type of risk to determine the feasibility of providing break-out of exposure by state, and, if feasible, the basis. Alternatively, a much simpler approach should be sought.

Hank Haldeman & Dave Leonard
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