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TO THE HOUSE COMMITTEES ON
CONSUMER PROTECTION AND COMMERCE
AND JUDICIARY

TWENTY-SIXTH LEGISLATURE
Regular Session of 2011

Wednesday, March 16, 2011
2:00 p.m.

TESTIMONY ON SENATE BILL NO. 1279 S.D. 1 – RELATING TO INSURANCE.

TO THE HONORABLE ROBERT HERKES AND GILBERT S.C. KEITH-AGARAN,
CHAIRS, AND MEMBERS OF THE COMMITTEES:

My name is Gordon Ito, State Insurance Commissioner ("Commissioner"),
testifying on behalf of the Department of Commerce and Consumer Affairs
("Department"). Thank you for hearing this bill. The Department strongly supports this
Administration bill as amended.

The purpose of this bill is to adopt the National Association of Insurance
Commissioners' ("NAIC") recommendations relating to the states' implementation of the
provisions of the federal Nonadmitted and Reinsurance Reform Act of 2010 ("NRRA")
as they relate to the states' regulation and taxation of surplus lines insurance. NRRA's
effective date is July 21, 2011. Surplus lines or nonadmitted insurance are insurance
contracts that cover risks in states where the insurer is not an admitted or authorized
insurance company.

The first of two significant changes is the regulation of surplus lines policies that cover risks in multiple states. Presently, each state with a covered risk may regulate the insured and the insurer. NRRRA limits the regulation of the surplus lines to solely the "home state" of the policyholder. The proposed legislation provides for the adoption of NAIC recommended definitions of "home state" and conforms to the NRRRA limitation.

The second significant change is to authorize on the home state to collect premium taxes on multi-state surplus lines policies. The home state may collect taxes for all affected states and distribute to each state their share of the taxes.

Adoption of NAIC's recommendations are essential for the Insurance Division to participate in the multi-state effort to regulate companies and to collect and distribute the premium taxes. Presently, the Insurance Division collects and deposits into the General Fund \$10,000,000 of surplus lines taxes. The proposed legislation is intended to authorize the Insurance Division to join with other states in arrangements that are being developed to ensure the continued receipt of the surplus lines taxes.

We thank this Committee for the opportunity to present testimony on this matter and ask for your favorable consideration.

S.B. 1279 - Testimony of NAPSLO

Kathy Matsumura [kym@charhamilton.com]

Sent: Tuesday, March 15, 2011 10:07 AM

To: CPCtestimony

Attachments: 31611HawaiiTestimony.pdf (23 KB)

Attached for submission to the House Committees on Consumer Protection & Commerce and Judiciary is the testimony of the National Association of Professional Surplus Lines Offices, relative to Senate Bill No. 1279 scheduled for hearing on March 16, 2011 @ 2:00 p.m.

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**TESTIMONY OF THE
NATIONAL ASSOCIATION OF PROFESSIONAL SURPLUS LINES OFFICES
BEFORE THE
HAWAII HOUSE CONSUMER PROTECTION AND JUDICIARY COMMITTEES
REGARDING S.B. 1279**

MARCH 16, 2011

- The National Association of Professional Surplus Lines Offices – NAPSLO would like to offer testimony on **S.B. 1279**, which would amend Hawaii Revised Statutes Chapter 431 to incorporate some elements of the Non-admitted and Reinsurance Reform Act, or the NRRA.
- 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 1975, NAPSLO has been a trusted voice on surplus lines issues in all 50 states, as well as in Washington D.C., for more than 35 years. NAPSLO is a valuable source of information regarding the vital role surplus lines plays in the insurance industry. NAPSLO has over 800 members representing 15,000-20,000 individual brokers, agents, companies, underwriters and other professionals.
- NAPSLO was one of the leading supporters of the NRRA, which was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. We therefore have a deep understanding of the provisions of the NRRA and its overall legislative purpose of streamlining the regulation of surplus lines and other non-admitted insurance and providing nationwide uniformity to resolve the confusing, and often conflicting, system of regulation and tax allocation on multi-state surplus lines risks. As you know, the NRRA takes effect on July 21, 2011, at which time only one state – the home state of the insured – will regulate a multistate surplus lines transaction.
- NAPSLO appreciates the opportunity to provide testimony regarding **S.B. 1279**, and specifically wishes to address the provisions of **S.B. 1279** that authorize the insurance commissioner to enter into an interstate compact or agreement for the allocation and sharing of premium taxes on multi-state insurance risks. This delegation of authority to the commissioner was suggested to authorize the commissioner to enter into an agreement known as the Nonadmitted Insurance Multistate Agreement or NIMA.
- NAPSLO's testimony today will focus on three points:
 - First, participation in an interstate agreement such as NIMA will neither cause a state to receive a windfall of additional tax revenue, nor it is necessary to avoid a significant loss in premium tax revenue.
 - Second, the provision of **S.B. 1279** that enables the insurance commissioner to enter into an interstate agreement for the allocation and sharing of premium taxes on multi-state insurance risks constitutes an improper delegation of authority to an administrative agency.
 - Third, the NIMA agreement contemplated by **S.B. 1279** perpetuates unnecessary, bureaucratic data reporting that is contrary to the letter and spirit of the NRRA.
- NAPSLO would like to dispel the myth that states that do not join an interstate agreement such as NIMA will experience a significant loss of premium tax revenue, and conversely, that states entering into such agreements will receive a windfall of additional tax dollars. The tax allocation and sharing contemplated by the NRRA applies only to *multi-state* risks. In Hawaii, as is true with most states, the vast majority of surplus lines policies are for *single state* risks; therefore the allocation and sharing provisions are inapplicable to taxes received from those policies.

- We have been told consistently by our brokers and other states that 90% or more of surplus lines policies concern single state risks. States with hurricane or earthquake exposures would be expected to have an even higher percentage of single state risks. We believe that estimates of multi-state risks of many states could be off by as much as 25-30%, therefore skewing fiscal impact estimates.
- Casualty insurance, which generally comprises half of the market, is typically considered a single state risk. Examples of casualty insurance include medical malpractice insurance, directors and officers insurance, excess liability policies and umbrella policies. The vast majority of Casualty business would be taxed exclusively by Hawaii unless it joins the NIMA agreement.
- When a state considers the gain or loss of revenue associated with participation in an interstate agreement such as NIMA, it must keep in mind that not only will the state receive premium tax funds from other states, but that state will also be forced to pay to other states the premium tax allocated to risks located outside its state.
- Typically, if a state decides not to join a multistate agreement such as NIMA, the gross premium tax dollars collected on multi-state "home state" policies that it refrains from sending to other compacting states, would offset the premium tax dollars it would have received from other states through NIMA agreement.
- Interstate tax agreements such as NIMA do not provide a windfall like grants. Any tax clearinghouse must be funded by states' tax revenue. While it's possible that some states may receive more revenue than they contributed by participating in NIMA, others will lose tax revenue by contributing more tax than they will receive. A state will not likely stay in an agreement such as NIMA that has as its only purpose to share tax revenue unless it receives more revenue than it contributes. Eventually an agreement that will only share tax revenue will fail because a state will not voluntarily contribute more than it receives.
- Because of this uncertainty, certain states have discussed various options to ensure that they will not lose revenue by joining NIMA.
 - One possibility is to make the NIMA agreement effective only when 25 states have joined.
 - Another is to conduct a fiscal impact study of the operational tax sharing agreements prior to entering NIMA but after there is a tax sharing agreement functioning.
 - A third is to require an administrative or legislative hearing through which a fiscal benefit must be demonstrated prior to joining NIMA.
- An interstate compact or agreement must be successfully established and endorsed by other states in order for a state to receive an allocated portion of the tax revenue contributed by other states. No such compact or agreement currently is operational. It is impossible to predict which states will participate in the compact, and what it will look like. In fact, there is no interstate compact in the country that involves all 50 states. It is impossible to make financial projections without knowing which states will actually participate in a tax sharing agreement such as NIMA.
- The provisions of **S.B. 1279** that enable the insurance commissioner to enter into an interstate compact or agreement for the allocation and sharing of premium taxes on multi-state insurance risks provide for an unlawful delegation of authority to an administrative agency. **S.B. 1279** provides the commissioner the discretion to enter into an interstate agreement to share Hawaii's premium tax revenues with other states. **SB 1279** would also constitute a tax increase on some policyholders. However, this proposal constitutes an improper delegation of policymaking and taxing authority to a state agency. Any tax sharing agreement should be specifically required by legislation and approved by the legislature. The decision cannot be delegated to an administrative agency. Hawaii's current proposal is not adequate to apprise policyholders, brokers or legislators of how burdensome and expensive NIMA will be.
 - The proposed legislation would require brokers placing insurance for a Hawaii "home state" insured

with multistate risks to apply the varying tax rates of each of the states where the insured has exposures. This would apparently be required even if the other states where those exposures are located do not participate in this new tax sharing system.

- NAPSLO opposes any provision taxing Hawaii policyholders at tax rates of other states as contrary to the NRRA and imposing administrative burdens on brokers and policyholders that the NRRA intended to remove.
- If the allocation and sharing of taxes among states is addressed at all, it should be addressed in connection with separate legislation specifically establishing a tax sharing arrangement, if any is adopted. The clear intent of the NRRA was to create a streamlined tax system that involves a payment to the home state of the insured using uniform requirements, forms and procedures. NIMA fails to accomplish either uniformity or efficiency.
- NIMA also perpetuates unnecessary, bureaucratic data reporting, with dozens of data elements and hundreds of state-specific tax nuances for every multi-state policy issued. NIMA would require the allocation of certain multi-state risks, including dozens of casualty lines, when most states currently do not require that these risks be allocated. NIMA's complex and novel allocation requirements will force policyholders to attempt to create or estimate data for the broker to report.
- Consistent with these comments, we respectfully request that the references to the commissioner's authority to enter an interstate agreement or compact be deleted from **S.B. 1279**. If the state ultimately determines it will benefit from a tax sharing agreement we would suggest that the state consider SLIMPACT as an option to avoid many of the issues outlined above.
- NAPSLO would be happy to work with the Members of the House Consumer Protection and Judiciary Committees to amend this bill to capture the letter and spirit of the NRRA.