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Testimony of the Department of Commerce and Consumer Affairs

Before the
House Committee on Finance
Friday, March 29, 2019
2:30 p.m.
State Capitol, Conference Room 308

On the following measure:
S.B. 19, S.D. 2, RELATING TO SURPLUS LINES

Chair Luke and Members of the Committee:

My name is Colin Hayashida, and I am the Insurance Commissioner of the Department of Commerce and Consumer Affairs' (Department) Insurance Division. The Department offers comments on this bill.

The purpose of this bill is to amend the calculation of surplus lines insurance premium tax to tax the entirety of the premium using the rate established by Hawaii statute, regardless of location of risk.

This bill would repeal language authorizing the Insurance Commissioner to enter an interstate compact to collect surplus lines premium taxes. Under current law, the interstate compact requires the State to, among other things, use a method in cooperation with other states in allocating risk and computing taxes due on premium to each state where properties, risks, or exposures are located. A very small minority of states have signed onto this interstate compact, and it is more beneficial for the State to use a system where surplus lines brokers make direct payments to the Director of Finance.

Thank you for the opportunity to testify on this bill.

American Property Casualty Insurance Association

To: The Honorable Sylvia Luke, Chair
The Honorable Ty Cullen, Vice Chair
House Committee on Finance

From: Mark Sektnan, Vice President

Re: **SB 19 SD2– Relating to Surplus Lines**
APCIA Position: Support

Date: Friday, March 29, 2019
2:30 p.m., Conference Room 308; Agenda #2

Aloha Chair Luke, Vice Chair Cullen and Members of the Committee:

The American Property Casualty Insurance Association (APCIA) is pleased to support SB 19 SD2 which would amend the calculation of surplus lines insurance premium tax to tax the entirety of the premium using the rate established by Hawaii statute regardless of location of risk. Representing nearly 60 percent of the U.S. property casualty insurance market, the American Property Casualty Insurance Association (APCIA) promotes and protects the viability of private competition for the benefit of consumers and insurers. APCIA represents the broadest cross-section of home, auto, and business insurers of any national trade association. APCIA members represent all sizes, structures, and regions, which protect families, communities, and businesses in the U.S. and across the globe. APCIA also includes member insurance companies that write over 70% of the surplus lines' premiums reported by U.S. insurers.

The APCIA has been a strong advocate for states to adopt the provisions of the Nonadmitted and Reinsurance Reform Act (NRRA), enacted within the Dodd-Frank Act of 2010 (DFA), which calls for greater uniformity and consistency across the states on the regulation and taxation of nonadmitted insurance, commonly known as surplus lines.

Since the effective date of the NRRA on July 21, 2011, 46 states have correspondingly amended their laws to streamline the taxation of surplus lines premiums on multi-state policies. In those states, the taxation rules of the home state of the insured[1] requires that

[1] 15 U.S.C. § 8206. Definitions. (6) Home State - (A) In general Except as provided in subparagraph (B), the term ''home State'' means, with respect to an insured— (i) the State in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence; or (ii) if 100 percent of the insured risk is located out of the State referred to in clause (i), the State to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.

100% of the gross premiums of the multi-state policy be solely subject to the tax rate of the home state. This subsequently eliminates the time-consuming computation, reporting, allocation, and reconciliation of state-by-state tax monies that ultimately are all retained by the home state.

So, as provided under the NRRA, SB 19 SD2 would likewise amend the calculation of surplus lines insurance premium tax where Hawaii is the home state of the insured to tax the entirety of the policy premium using the rate established by Hawaii statute regardless of where other parts of the insured's risks are located.

The surplus lines market represents only around 7% of the premium writings in the property & casualty insurance industry. However, it responds to critical insurance needs for commercial and individual consumers who cannot otherwise find their necessary insurance coverage in the standard admitted market. The APCIA believes SB 19 SD2 not only appropriately addresses the Congressional call under the NRRA, it further enables this efficient and effective response to the benefit of the Hawaii marketplace.

For these reasons, APCIA asks for your support of SB 19 SD2.

To: The Honorable Sylvia Luke, Chair
The Honorable Ty Cullen, Vice Chair
House Committee on Finance

FROM: John Meetz, State Relations Manager
Wholesale and Specialty Insurance Association (WSIA)

Re: SB 19 SD2 - Relating to Surplus Lines
Position: SUPPORT with amended effective date

Date: Friday, March 29, 2019
2:30 p.m., Conference Room 308

Aloha Chair Luke, Vice Chair Cullen and Members of the Committee:

The Wholesale & Specialty Insurance Association (WSIA)[1] appreciates the opportunity to provide testimony in strong support of SB 19 SD2, regarding surplus lines insurance premium taxes. We respectfully request the committee to pass the bill, which will conform Hawaii's statutes to the current national standard practice, with an amended effective date of October 1, 2019.

We would like to provide some background on surplus lines insurance and the unique process for collecting surplus lines tax. Surplus lines insurance premium tax is collected differently than standard insurance premium tax for admitted lines. It is the responsibility of the insurance broker to collect the tax from the consumer and pay the tax to the state. This differs from a standard insurance transaction where the tax is included as part of the consumer's insurance premium and paid by the insurance company to the state.

In 2010, Congress passed the Nonadmitted and Reinsurance Reform Act (NRRA) as part of the Dodd Frank Act. The purpose of the NRRA was to achieve a simpler and more efficient system of regulation and taxation of the surplus lines industry by establishing the insured's (the consumer's) "home state" as the one and only jurisdiction to regulate and tax surplus lines transactions. Because of the NRRA, surplus lines insurance transactions are now regulated solely by the "home state" of the consumer. Therefore, if a consumer, whether an individual or a business, is principally located in Hawaii, then Hawaii regulates the entire transaction, even when parts of the risk are located in other states.

[1] Effective August 1, 2017, the National Association of Professional Surplus Lines Offices (NAPSLO) and the American Association of Managing General Agents (AAMGA) merged to form the WSIA. WSIA is the U.S. professional trade association representing the wholesale and specialty insurance market and the wholesale distribution system. WSIA presents approximately 400 wholesale broker member firms, 100 surplus lines insurance companies, and 200 associates and service providers to the surplus lines market, our membership operates in more than 1,500 offices representing tens of thousands of individual brokers, insurance company professionals, underwriters and other insurance professionals worldwide – all of whom are committed to the wholesale distribution system and U.S. surplus lines market.

As part of the implementation of the NRRA, Congress allowed states to voluntarily enter into tax sharing agreements, and for a short time, several states pursued agreements to enact reciprocal allocation procedures. The current law governing Hawaii surplus lines taxation passed in 2011 in anticipation of joining one of these reciprocal allocation procedures as soon as it became viable. Evidence ultimately emerged showing that the reciprocal allocation procedures resulted in an inefficient tax structure and each of the agreements eventually dissolved. In their place, states embraced the "home state" approach of taxing and retaining 100% of the premiums at the home state rate.

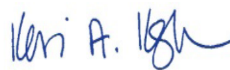
Although Hawaii retains 100% of the tax that is remitted to the state, risks that are located outside Hawaii are taxed based on where the risk resides, rather than exclusively at the Hawaii rate (4.68%). This results in unnecessary regulatory burdens for the broker, requires a difficult allocation of risk when it resides in multiple states, results in additional costs of compliance which ultimately impacts the consumer, and in some cases, collects less tax for the state than the amount to which it is legally entitled. SB 19 would amend Hawaii law to tax all surplus lines premiums, for which Hawaii is the home state, entirely at the home state rate of 4.68%, just as 46 states plus the District of Columbia and Puerto Rico do today (legislation is pending in all four remaining states).

In addition to easing the regulatory burden for surplus lines brokers, another beneficial effect of this legislation will likely be increased premium tax revenue. Hawaii's tax rate of 4.68% exceeds the average U.S. surplus lines premium tax rate of 3.53%. Because of this, most insurance policies that contain multi-state premium are currently being taxed at a rate below the 4.68% Hawaii rate and below the states authority under the NRRA. For surplus lines insurance policies where Hawaii is the "home state," SB 19 SD2 would amend the law to tax all surplus lines premium at 4.68% regardless of the location of that risk.

SB 19 SD2 would codify the "home state" approach in Hawaii as it has been done in most of the U.S. and is being pursued in the remaining states. In passing SB 19 SD2, Hawaii will reduce the regulatory burden for local surplus lines brokers, simplify compliance procedures for brokers and regulators, increase nationwide uniformity in surplus lines taxation and very likely increase premium tax revenue for the state.

WSIA strongly supports the measure and respectfully requests your committee to delay the effective date of the bill to 90 days following the enactment of the legislation to allow surplus lines brokers to accurately tax any transactions that are pending in proximity to the date of signing. Thank you for your time on this much needed legislation.

Sincerely,



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