HOUSE BILL REPORT
HB 1694

As Passed Legislature

Title: An act relating to unauthorized insurance.

Brief Description: Regulating unauthorized insurance.

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

Brief History:
Committee Activity:
Business & Financial Services: 2/1/11, 2/4/11 [DP];
Ways & Means: 2/17/11, 2/23/11 [DP].
Floor Activity:
Passed House: 3/5/11, 98-0.
Passed Senate: 3/28/11, 48-0.
Passed Legislature.

Brief Summary of Bill

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

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: Do pass. Signed by 13 members: Representatives Kirby, Chair; Kelley, Vice Chair; Bailey, Ranking Minority Member; Buys, Assistant Ranking Minority Member; Blake, Condotta, Hudgins, Hurst, Parker, Pedersen, Rivers, Ryu and Stanford.

Staff: Jon Hedegard (786-7127).

HOUSE COMMITTEE ON WAYS & MEANS

Majority Report: Do pass. Signed by 26 members: Representatives Hunter, Chair; Darneille, Vice Chair; Hasegawa, Vice Chair; Alexander, Ranking Minority Member; Bailey,

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Assistant Ranking Minority Member; Dammeier, Assistant Ranking Minority Member; Orcutt, Assistant Ranking Minority Member; Carlyle, Chandler, Cody, Dickerson, Haigh, Haler, Hinkle, Hudgins, Hunt, Kagi, Kenney, Ormsby, Parker, Pettigrew, Ross, Schmick, Seaquist, Springer and Wilcox.

Staff: Rick Peterson (786-7150).

Background:

Surplus Lines Insurance.
Generally, an insurance company cannot engage in the business of insurance in the state unless the insurance company is authorized to do so by the Office of the Insurance Commissioner (OIC). "Surplus lines" insurance coverage is an exception. Surplus lines insurance is coverage that cannot be procured from authorized insurance companies. Often, surplus lines policies cover risks that do not fit normal underwriting patterns or fit standard insurance policies. Unlike insurance offered by an authorized insurer, surplus lines insurance is not subject to rate and policy form oversight. Under insurance statutes, if coverage cannot be purchased from an authorized insurer, the coverage may be purchased from an unauthorized insurer through a licensed surplus lines broker if:
- a diligent effort is made to find the coverage from authorized insurers; and
- the purpose for using an unauthorized insurer is something other than securing a lower premium rate than would be accepted by any authorized insurer.

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

Licensing requirements regarding surplus lines brokers include:
- background checks, including fingerprints;
- minimum bonding amounts;
- record-keeping; and
- reporting.

Capital Requirements for Unauthorized Insurers.
A surplus lines broker must not knowingly place surplus lines insurance with an insurer that is not financially sound. The surplus lines broker must determine and document the financial condition of the unauthorized insurer before placing insurance with the insurer. The surplus lines broker may not place insurance with:
- any foreign insurer unless the insurer has at least $1.5 million in capital and $6 million of capital and surplus;
- any alien insurer unless the insurer has $15 million of capital and surplus and meets specific requirements regarding the manner in which alien insurers must hold funds;
- any group including incorporated and individual insurers unless the group maintains a trust fund of $50 million as security and meets specific requirements regarding the manner in which the group must hold funds; or

- any insurance exchange created by the laws of a state unless the exchange maintains capital and surplus of $50 million in the aggregate and meets other specific requirements for exchanges.

Surplus Lines Premium Tax.
A surplus lines broker must pay a premium tax of 2 percent on surplus lines insurance transacted by the broker. The tax is credited to the General Fund. If a surplus lines policy covers risks or exposures that are only partially located in this state, the tax is computed upon the proportion of the risks or exposures located in this state.

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

- provides definitions;
- precludes any state other than the home state of an insured from taxing premiums on surplus lines insurance.
- allows states to enter into a compact to allocate taxes on risks that involve more than one state;
- limits the regulation of the placement of surplus lines insurance to the requirements of the insured's home state, including the licensure of surplus lines brokers;
- prohibits a state from imposing a due diligence search on a surplus lines broker when the broker is seeking to procure insurance for an exempt commercial purchaser and certain criteria are met;
- prohibits states from collecting any fees relating to licensing of a surplus lines broker unless the state has laws or regulations that provide for participation by the state in a national uniform national database for the licensure of surplus lines brokers;
- prohibits a state from imposing eligibility requirements on surplus lines insurers domiciled in the United States unless the state has adopted nationwide uniform requirements, forms, and procedures, including alternative nationwide uniform eligibility requirements; and
- prohibits states from preventing a surplus lines broker from placing surplus lines insurance with certain surplus lines insurers.

Summary of Bill:

Insured's Home State.
"Insured's home state" is defined:

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

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

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

Exemption for Certain Commercial Purchasers.
A person is an "exempt commercial purchaser" if the person:
- employs or retains a qualified risk manager to negotiate insurance coverage;
- has paid aggregate commercial property and casualty insurance premiums exceeding $100,000 in the previous year; and
- meets additional financial criteria.

A surplus lines broker seeking to procure from or place insurance with an unauthorized insurer for an exempt commercial purchaser is not required to satisfy the diligent effort requirement if the:
- surplus lines broker or referring insurance producer placing the surplus lines insurance discloses that the insurance may or may not be available from the admitted market and that insurance may provide greater protection with more regulatory oversight; and
- exempt commercial purchaser subsequently requests the surplus lines broker or referring insurance producer in writing to procure or place such insurance from an unauthorized insurer.

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

Capital Requirements for Unauthorized Insurers.
A surplus lines broker may only place insurance with:
- a foreign insurer authorized to write the same type of insurance in its domiciliary jurisdiction that has capital and surplus equal to the greater of the minimum capital and surplus requirements of this state or $15 million. The OIC may waive the financial requirements if the foreign insurer's capital and surplus is at least $4.5 million and the OIC finds the insurer is acceptable; or
- an alien insurer that is on the quarterly listing of alien insurers maintained by the National Association of Insurance Commissioners.

Specific requirements regarding groups and exchanges are struck.

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

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains an emergency clause and takes effect on July 21, 2011, except for section 3, which replaces an expiring section, and takes effect on December 31, 2016.

Staff Summary of Public Testimony (Business & Financial Services):

(In support) This bill updates and streamlines the regulation of surplus lines insurance. It makes changes in taxation to comply with federal statutes. The bill brings this state's laws into conformity with the laws of other states. The emergency clause is necessary because of the federal law. The bill reflects the changes in federal law. The federal law requires a number of these concepts. The federal law takes effect on July 21, 2011. Without the emergency clause there would be a period of time where state laws are preempted but laws to implement the federal law are not yet in place. The tax provisions change the basis of taxation for some types of coverage. The state will be able to tax certain out-of-state risks. The amount of money is difficult to calculate but the current estimate is about $100,000 per month in revenue. The surplus lines brokers have been monitoring the implementation of the federal law. The surplus lines brokers worked with the OIC on the development of this bill and support the bill.

(Opposed) None.

Staff Summary of Public Testimony (Ways & Means):

(In support) This bill is about coming into conformity with what is going on in the rest of the country and making sure that Washington does not miss out on revenue as the other states switch over to the new system. There are also efficiency improvements in the bill. Most states are in the process of adopting a bill similar to this bill. If we do not adopt this bill, Washington will be preempted by the Dodd-Frank Act. Everyone must switch over to the new tax base, which is the home state rather than the location of the risk.

(Opposed) None.

Persons Testifying (Business & Financial Services): Representative Stanford, prime sponsor; Drew Bouton and John Hamje, Office of the Insurance Commissioner; and Bob Hope, Surplus Line Association of Washington.

Persons Testifying (Ways & Means): Representative Stanford, prime sponsor; and Drew Bouton, Office of the Insurance Commissioner.

Persons Signed In To Testify But Not Testifying (Business & Financial Services): None.

Persons Signed In To Testify But Not Testifying (Ways & Means): None.