109TH CONGRESS 2d Session } HOUSE OF REPRESENTATIVES { REPT. 109–649 Part 1

NONADMITTED AND REINSURANCE REFORM ACT OF 2006

SEPTEMBER 12, 2006.—Ordered to be printed

Mr. OXLEY, from the Committee on Financial Services, submitted the following

R E P O R T

[To accompany H.R. 5637]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 5637) to streamline the regulation of nonadmitted insurance and reinsurance, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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AMENDMENT

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the “Nonadmitted and Reinsurance Reform Act of 2006”.

49–006

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title and table of contents.
Sec. 2. Effective date.

TITLE I—NONADMITTED INSURANCE

Sec. 101. Reporting, payment, and allocation of premium taxes.
Sec. 102. Regulation of nonadmitted insurance by insured's home State.
Sec. 103. Participation in national producer database.
Sec. 104. Uniform standards for surplus lines eligibility.
Sec. 105. Streamlined application for commercial purchasers.
Sec. 106. GAO study of nonadmitted insurance market.
Sec. 107. Definitions.

TITLE II—REINSURANCE

Sec. 201. Regulation of credit for reinsurance and reinsurance agreements.
Sec. 202. Regulation of reinsurer solvency.
Sec. 203. Definitions.

SEC. 2. EFFECTIVE DATE.

Except as otherwise specifically provided in this Act, this Act shall take effect upon the expiration of the 12-month period beginning on the date of the enactment of this Act.

TITLE I—NONADMITTED INSURANCE

SEC. 101. REPORTING, PAYMENT, AND ALLOCATION OF PREMIUM TAXES.

(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).

(2) EFFECTIVE DATE.—Except as expressly otherwise provided in such compact or other procedures, any such compact or other procedures—

(A) if adopted on or before the expiration of the 330-day period that begins on the date of the enactment of this Act, shall apply to any premium taxes that, on or after such date of enactment, are required to be paid to any State that is subject to such compact or procedures; and

(B) if adopted after the expiration of such 330-day period, shall apply to any premium taxes that, on or after January 1 of the first calendar year that begins after the expiration of such 330-day period, are required to be paid to any State that is subject to such compact or procedures.

(3) REPORT.—Upon the expiration of the 330-day period referred to in paragraph (2), the NAIC may submit a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate identifying and describing any compact or other procedures for allocation among the States of premium taxes that have been adopted during such period by any States.

(4) NATIONWIDE SYSTEM.—The Congress intends that each State adopt a nationwide or uniform procedure, such as an interstate compact, that provides for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance consistent with this section.

(c) ALLOCATION BASED ON TAX ALLOCATION REPORT.—To facilitate the payment of premium taxes among the States, an insured's home State may require surplus lines brokers and insureds who have independently procured insurance to annually file tax allocation reports with the insured's home State detailing the portion of the nonadmitted insurance policy premium or premiums attributable to properties, risks or exposures located in each State. The filing of a nonadmitted insurance tax allocation report and the payment of tax may be made by a person authorized by the insured to act as its agent.

SEC. 102. REGULATION OF NONADMITTED INSURANCE BY INSURED'S HOME STATE.

(a) HOME STATE AUTHORITY.—Except as otherwise provided in this section, the placement of nonadmitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's home State.

(b) BROKER LICENSING.—No State other than an insured's home State may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate nonadmitted insurance with respect to such insured.

(c) ENFORCEMENT PROVISION.—Any law, regulation, provision, or action of any State that applies or purports to apply to nonadmitted insurance sold to, solicited by, or negotiated with an insured whose home State is another State shall be preempted with respect to such application.

(d) WORKERS' COMPENSATION EXCEPTION.—This section may not be construed to preempt any State law, rule, or regulation that restricts the placement of workers' compensation insurance or excess insurance for self-funded workers' compensation plans with a nonadmitted insurer.

SEC. 103. PARTICIPATION IN NATIONAL PRODUCER DATABASE.

After the expiration of the 2-year period beginning on the date of the enactment of this Act, a State may not collect any fees relating to licensing of an individual or entity as a surplus lines broker in the State unless the State has in effect at such time laws or regulations that provide for participation by the State in the national insurance producer database of the NAIC, or any other equivalent uniform national database, for the licensure of surplus lines brokers and the renewal of such licenses.

SEC. 104. UNIFORM STANDARDS FOR SURPLUS LINES ELIGIBILITY.

A State may not—

(1) impose eligibility requirements on, or otherwise establish eligibility criteria for, nonadmitted insurers domiciled in a United States jurisdiction, except in conformance with section 5A(2) and 5C(2)(a) of the Non-Admitted Insurance Model Act; and

(2) prohibit a surplus lines broker from placing nonadmitted insurance with, or procuring nonadmitted insurance from, a nonadmitted insurer domiciled outside the United States that is listed on the Quarterly Listing of Alien Insurers maintained by the International Insurers Department of the NAIC.

SEC. 105. STREAMLINED APPLICATION FOR COMMERCIAL PURCHASERS.

A surplus lines broker seeking to procure or place nonadmitted insurance in a State for an exempt commercial purchaser shall not be required to satisfy any State requirement to make a due diligence search to determine whether the full amount or type of insurance sought by such exempt commercial purchaser can be obtained from admitted insurers if—

(1) the broker procuring or placing the surplus lines insurance has disclosed to the exempt commercial purchaser that such insurance may or may not be available from the admitted market that may provide greater protection with more regulatory oversight; and

(2) the exempt commercial purchaser has subsequently requested in writing the broker to procure or place such insurance from a nonadmitted insurer.

SEC. 106. GAO STUDY OF NONADMITTED INSURANCE MARKET.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study of the nonadmitted insurance market to determine the effect of the enactment of this title on the size and market share of the nonadmitted insurance market for providing coverage typically provided by the admitted insurance market.

(b) CONTENTS.—The study shall determine and analyze—

(1) the change in the size and market share of the nonadmitted insurance market and in the number of insurance companies and insurance holding companies providing such business in the 18-month period that begins upon the effective date of this Act;

(2) the extent to which insurance coverage typically provided by the admitted insurance market has shifted to the nonadmitted insurance market;

(3) the consequences of any change in the size and market share of the nonadmitted insurance market, including differences in the price and availability of coverage available in both the admitted and nonadmitted insurance markets;

(4) the extent to which insurance companies and insurance holding companies that provide both admitted and nonadmitted insurance have experienced shifts in the volume of business between admitted and nonadmitted insurance; and

(5) the extent to which there has been a change in the number of individuals who have nonadmitted insurance policies, the type of coverage provided under such policies, and whether such coverage is available in the admitted insurance market.

(c) CONSULTATION WITH NAIC.—In conducting the study under this section, the Comptroller General shall consult with the NAIC.

(d) REPORT.—The Comptroller General shall complete the study under this section and submit a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate regarding the findings of the study not later than 30 months after the effective date of this Act.

SEC. 107. DEFINITIONS.

For purposes of this title, the following definitions shall apply:

(1) ADMITTED INSURER.—The term "admitted insurer" means, with respect to a State, an insurer licensed to engage in the business of insurance in such State.

(2) EXEMPT COMMERCIAL PURCHASER.—The term "exempt commercial purchaser" means any person purchasing commercial insurance that meets the following requirements:

(A) The person employs or retains a qualified risk manager to negotiate insurance coverage.

(B) The person has paid aggregate nationwide commercial property and casualty insurance premiums in excess of $100,000 in the immediately preceding 12 months.

(C) The person meets at least one of the following criteria:

(i) The person possesses a net worth in excess of $20,000,000.

(ii) The person generates annual revenues in excess of $50,000,000.

(iii) The person employs more than 500 full time or full time equivalent employees per individual insured or is a member of affiliated group employing more than 1,000 employees in the aggregate.

(iv) The person is a not-for-profit organization or public entity generating annual budgeted expenditures of at least $30,000,000.

(v) The person is a municipality with a population in excess of 50,000 persons.

(3) HOME STATE.—The term "home State" means the State in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence.

(4) INDEPENDENTLY PROCURED INSURANCE.—The term "independently procured insurance" means insurance procured directly by an insured from a nonadmitted insurer.

(5) NAIC.—The term "NAIC" means the National Association of Insurance Commissioners or any successor entity.

(6) NONADMITTED INSURANCE.—The term "nonadmitted insurance" means any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance.

(7) NON-ADMITTED INSURANCE MODEL ACT.—The term "Non-Admitted Insurance Model Act" means the provisions of the Non-Admitted Insurance Model Act, as adopted by the NAIC on August 3, 1994, and amended on September 30, 1996, December 6, 1997, October 2, 1999, and June 8, 2002.

(8) NONADMITTED INSURER.—The term "nonadmitted insurer" means, with respect to a State, an insurer not licensed to engage in the business of insurance in such State.

(9) QUALIFIED RISK MANAGER.—The term "qualified risk manager" means, with respect to a policyholder of commercial insurance, a person who meets all of the following requirements:

(A) The person is an employee of, or third party consultant retained by, the commercial policyholder.

(B) The person provides skilled services in loss prevention, loss reduction, or risk and insurance coverage analysis, and purchase of insurance.

(C) The person possesses at least two of the following credentials:

(i) An advanced degree in risk management issued by an accredited college or university.

(ii) At least 5 years of experience in one or more of the following areas of commercial property insurance or commercial casualty insurance:

(I) Risk financing.

(II) Claims administration.

(III) Loss prevention.

(IV) Risk and insurance coverage analysis.

(iii) At least one of the following designations:

(I) A designation as a Chartered Property and Casualty Underwriter (in this clause referred to as "CPCU") issued by the American Institute for CPCU/Insurance Institute of America.

(II) A designation as an Associate in Risk Management (ARM) issued by American Institute for CPCU/Insurance Institute of America.

(III) A designation as a Certified Risk Manager (CRM) issued by the National Alliance for Insurance Education & Research.

(IV) A designation as a RIMS Fellow (RF) issued by the Global Risk Management Institute.

(V) Any other designation, certification, or license determined by a State insurance commissioner or other State insurance regulatory official or entity to demonstrate minimum competency in risk management.

(10) PREMIUM TAX.—The term "premium tax" means, with respect to surplus lines or independently procured insurance coverage, any tax, fee, assessment, or other charge imposed by a State on an insured based on any payment made as consideration for an insurance contract for such insurance, including premium deposits, assessments, registration fees, and any other compensation given in consideration for a contract of insurance.

(11) SURPLUS LINES BROKER.—The term "surplus lines broker" means an individual, firm, or corporation which is licensed in a State to sell, solicit, or negotiate insurance on properties, risks, or exposures located or to be performed in a State with nonadmitted insurers.

(12) STATE.—The term "State" includes any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa.

TITLE II—REINSURANCE

SEC. 201. REGULATION OF CREDIT FOR REINSURANCE AND REINSURANCE AGREEMENTS.

(a) CREDIT FOR REINSURANCE.—If the State of domicile of a ceding insurer is an NAIC-accredited State, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, and recognizes credit for reinsurance for the insurer's ceded risk, then no other State may deny such credit for reinsurance.

(b) ADDITIONAL PREEMPTION OF EXTRATERRITORIAL APPLICATION OF STATE LAW.—In addition to the application of subsection (a), all laws, regulations, provisions, or other actions of a State other than those of the State of domicile of the ceding insurer are preempted to the extent that they—

(1) restrict or eliminate the rights of the ceding insurer or the assuming insurer to resolve disputes pursuant to contractual arbitration to the extent such contractual provision is not inconsistent with the provisions of title 9, United States Code;

(2) require that a certain State's law shall govern the reinsurance contract, disputes arising from the reinsurance contract, or requirements of the reinsurance contract;

(3) attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract, to the extent that the terms are not inconsistent with this title; or

(4) otherwise apply the laws of the State to reinsurance agreements of ceding insurers not domiciled in that State.

SEC. 202. REGULATION OF REINSURER SOLVENCY.

(a) DOMICILIARY STATE REGULATION.—If the State of domicile of a reinsurer is an NAIC-accredited State or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, such State shall be solely responsible for regulating the financial solvency of the reinsurer.

(b) NONDOMICILIARY STATES.—

(1) LIMITATION ON FINANCIAL INFORMATION REQUIREMENTS.—If the State of domicile of a reinsurer is an NAIC-accredited State or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, no other State may require the reinsurer to provide any additional financial information other than the information the reinsurer is required to file with its domiciliary State.

(2) RECEIPT OF INFORMATION.—No provision of this section shall be construed as preventing or prohibiting a State that is not the State of domicile of a reinsurer from receiving a copy of any financial statement filed with its domiciliary State.

SEC. 203. DEFINITIONS.

For purposes of this title, the following definitions shall apply:

(1) CEDING INSURER.—The term "ceding insurer" means an insurer that purchases reinsurance.

(2) DOMICILIARY STATE.—The terms "State of domicile" and "domiciliary State" means, with respect to an insurer or reinsurer, the State in which the insurer or reinsurer is incorporated or entered through, and licensed.

(3) REINSURANCE.—The term “reinsurance” means the assumption by an insurer of all or part of a risk undertaken originally by another insurer.

(4) REINSURER.—

(A) IN GENERAL.—The term “reinsurer” means an insurer to the extent that the insurer—

(i) is principally engaged in the business of reinsurance;

(ii) does not conduct significant amounts of direct insurance as a percentage of its net premiums; and

(iii) is not engaged in an ongoing basis in the business of soliciting direct insurance.

(B) DETERMINATION.—A determination of whether an insurer is a reinsurer shall be made under the laws of the State of domicile in accordance with this paragraph.

(5) STATE.—The term “State” includes any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Northern Mariana Islands, the Virgin Islands, and American Samoa.

PURPOSE AND SUMMARY

H.R. 5637, the Nonadmitted and Reinsurance Reform Act of 2006, will reform and modernize two important sectors of the commercial insurance marketplace, nonadmitted insurance (also known as “surplus lines”) and reinsurance. Specifically, H.R. 5637 creates a uniform system for nonadmitted insurance premium tax payments based upon the home State of the policyholder, encourages the States to develop a compact or other procedural mechanism for uniform tax allocation, and establishes regulatory deference for the home state of the insured. The bill adopts uniform eligibility requirements for nonadmitted insurers as developed and promulgated by the National Association of Insurance Commissioners (NAIC) in the Nonadmitted Insurance Model Act. H.R. 5637 will allow direct access to the nonadmitted insurance markets for certain sophisticated commercial purchasers, bypassing inefficient state declination rules.

H.R. 5637 streamlines the regulation of reinsurance by applying single State regulation for financial solvency and credit for reinsurance. Credit for reinsurance determinations will be controlled by the State of domicile of the ceding insurer. Reinsurance solvency regulation will be controlled by the State of domicile of the reinsurer provided such State is NAIC-accredited or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation. Non-domiciliary States are specifically prohibited from applying their reinsurance laws in an extraterritorial manner.

BACKGROUND AND NEED FOR LEGISLATION

The terrorist attacks of September 11, 2001 and the catastrophic storms of 2004 and 2005 caused some insurers in the standard market to withdraw or reduce their underwriting coverage in many critical sectors of the insurance market. Nonadmitted insurance and reinsurance provide significant flexibility and additional capacity required by the catastrophic and specialty markets to provide coverage for risks that would not otherwise be insurable.

Nonadmitted Insurance: Nonadmitted insurance provides coverage for unique or hard to place risks where coverage is generally unavailable through the traditional insurance market. The vast majority of nonadmitted insurance polices are sold to sophisticated businesses and cover specialized risks, such as extreme catastrophic coverage and terrorism. Nonadmitted insurers are not required to file rates or policy forms with State regulators, giving them flexibility to develop specialized coverage and rates for each distinctive risk. Nonadmitted insurance policyholders are not covered under State guarantee funds, since the special nature of surplus lines insurance oftentimes forces them to obtain coverage outside of their home State.

States collect premium taxes for nonadmitted insurance placements, but the tax allocation and remittance formulas and procedures vary significantly from State to State and are often in direct conflict. When a nonadmitted policy involves multi-state risk, it can be extremely difficult to determine how much tax is owed to each State and, as a result, multiple taxation or noncompliance often results. On June 21, 2006, the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing entitled "Commercial Insurance Modernization," (hereinafter the "June 21, 2006 hearing"). At that hearing, witness testimony detailed the problems associated with State premium tax collection procedures. For example, some States use a "single situs" approach, which requires that 100 percent of the premium tax be paid to the insured's State of domicile. This single situs approach is in accordance with the United States Supreme Court's ruling in *State Bd. of Ins.* v. *Todd Shipyards Corp.,* 370 U.S. 451 (1962), which ruled that a State is not entitled to tax or regulate surplus lines transactions merely because a surplus lines policy insures property or risk located in that State. The Court held in Todd Shipyards that the imposition of any such tax violates the due process clause of the Fourteenth Amendment to the United States Constitution and also exceeds the scope of the McCarran-Ferguson Act delegation of primary insurance regulatory authority to the States.

Despite the Todd Shipyards decision, most States use different conflicting allocation and apportionment formulas and procedures based on the location of the risk in determining the amount of premium tax owed. Thus, if a policy covers property in both a single situs State and an apportionment State, double taxation on the same portion of the same policy is unavoidable. More than a dozen States do not have regulatory provisions indicating the State's tax allocation method, leaving it up to the insured and the insured's broker to determine how to comply with the state law. Witnesses at the June 21, 2006 hearing testified that the conflicting State formulas sometimes result in impossible compliance and enormous burdens, administrative costs, and paperwork for commercial consumers and their brokers who bear the costs of navigating the tax labyrinth of state rules. By codifying the single situs rule, the Committee recognizes that an insured's purchase of non-compulsory surplus lines coverage protects against the potential financial risk posed to the insured, with that risk being located in, and fully apportioned to, the State of the insured's principal place of business.

Nonadmitted broker licensing requirements and renewal schedules also vary from State to State. Brokers engaging in nonadmitted insurance transactions that involve multi-State risks currently must obtain a license in each State where exposures are located. This means that a nonadmitted broker may be required to maintain up to 50 licenses in order to handle a single multi-State insurance policy. Witness testimony at the June 21, 2006 hearing affirmed that duplicative licensing requirements have caused administrative burdens and created expenses that negatively impact policyholders. Nonadmitted agents and brokers are subject to additional duplicative regulatory requirements including multiple tax filings, multiple diligent search requirements, and multiple regulatory filings.

Eligibility requirements for nonadmitted insurers also vary from State to State, oftentimes making it difficult to find insurers that are eligible in all States in which a multi-State policy is sought. In addition, access to the nonadmitted marketplace is limited, with States requiring nonadmitted brokers to "diligently search" the admitted markets for coverage, even for insurance contracts for sophisticated commercial purchasers whose coverage needs cannot be met in the admitted market.

Reinsurance: Reinsurance is insurance for insurance companies. Primary insurance companies (ceding insurers) purchase coverage by ceding or transferring a portion of their risk exposure to a reinsurer. Reinsurance effectively increases an insurer's capacity to underwrite more coverage. Reinsurance performs an essential role in the insurance marketplace by limiting ceding insurers' liability exposure on large risks, adding insurance capacity, and protecting against mega-catastrophes.

State laws on credit for reinsurance determine the conditions under which a ceding insurer domiciled in a State can take credit for reinsurance either as an asset or as a reduction of liabilities on their financial statements. As such, credit for reinsurance laws contain a strong incentive for compliance because there are few situations in which a ceding insurer would be willing to pay out premiums to a reinsurer without being able to reflect a subsequent increase in assets or reduction in its liabilities. Some States refuse to accept findings by ceding insurers' domiciliary States that their reinsurance contracts qualify for credit for reinsurance, causing the ceding insurers' balance sheets to vary from State to State and limiting the value of the reinsurance. These State restrictions then become competing and sometimes conflicting de facto nationwide standards. These state practices are known as "extra-territorial regulation" since the non-domiciliary state is attempting to regulate beyond its borders. For example, at the June 21, 2006 hearing, witnesses testified about examples of extra-territorial application of State law, such as unilateral and extra-territorial State invalidation of arbitration clauses, choice of law provisions, and imposition of contract terms that are materially different than those negotiated by the parties in reinsurance contracts. This extra-territorial application of State law reduced catastrophic capacity and limited the benefits of the reinsurance markets by undercutting the contracting ability of parties.

Although the domiciliary State of a reinsurance company has the primary responsibility for evaluating that company's financial condition and solvency. Any State in which the reinsurer is licensed may conduct its own evaluation. Financial solvency and reporting requirements vary from State to State, resulting in conflicting or duplicative financial statement filing and financial solvency requirements on reinsurers. At the hearing, witnesses testified that duplicative solvency regulation has led to increased transaction costs for insurers and ultimately consumers.

The Committee has held numerous hearings on the modernization of insurance regulation, including a hearing specifically on H.R. 5637 on June 21, 2006 to identify the problems in the nonadmitted and reinsurance marketplace, the potential consequences to consumers, and to analyze the potential remedies included in the bill.

HEARINGS

The Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held a hearing on June 21, 2006, on H.R. 5637, entitled "Commercial Insurance Modernization". Witnesses included Tom Minkler of the Independent Insurance Agents and Brokers of America, Scott Sinder of the Council of Insurance Agents & Brokers, Bernd Heinze of the American Association of Managing General Agents, Janice Ochenkowski of the Risk and Insurance Management Society, Franklin Nutter of the Reinsurance Association of America, David Gates of the American Council of Life Insurers, and Richard Bouhan of the National Association of Professional Surplus Lines Offices, Ltd. The American Association of Independent Claims Professionals submitted testimony for the record.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on July 26, 2006, and ordered reported H.R. 5637, Nonadmitted and Reinsurance Reform Act of 2006, as amended, to the House by a voice vote. Previously, the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises met in open session on July 19, 2006, to consider H.R. 5637. The Subcommittee approved the measure for Full Committee consideration after agreeing to an amendment in the nature of a substitute offered by Mr. Baker, No. 1, making a number of technical and substantive changes to the bill, by a voice vote.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. No record votes were taken in conjunction with the consideration of this legislation. A motion by Mr. Oxley to report the bill, as amended, to the House with a favorable recommendation was agreed to a by a voice vote. During the consideration of this bill, the following amendments were considered:

An amendment in the nature of a substitute recommended by the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, making various technical and substantive changes, as amended, was AGREED TO by a voice vote.

The following amendment to the Subcommittee amendment was considered:

An amendment by Mr. Oxley (No. 1), making technical changes and requiring a GAO study, was AGREED TO by a voice vote.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee held a hearing and made findings that are reflected in this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee establishes the following performance related goals and objectives for this legislation:

H.R. 5637, the Nonadmitted and Reinsurance Reform Act of 2006, simplifies, streamlines, and improves the regulation of the nonadmitted insurance and the reinsurance marketplaces by applying exclusive domiciliary State regulation and uniform standards.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATE

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

AUGUST 11, 2006.

Hon. MICHAEL G. OXLEY,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 5637, the Nonadmitted and Reinsurance Reform Act of 2006.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Sarah Puro.

Sincerely,

DONALD B. MARRON,
Acting Director.

Enclosure.

H.R. 5637—Nonadmitted and Reinsurance Reform Act of 2006

Summary: H.R. 5637 would create a uniform system for taxing and regulating certain types of insurance products. Specifically, the bill would establish national standards for how states may regulate, collect, and allocate taxes for a type of insurance that covers unique or atypical risks—known as “surplus lines” or “nonadmitted insurance.” The bill also would establish national standards for how states regulate reinsurance—often referred to as insurance for insurance companies. In addition, the legislation would require a study by the Government Accountability Office (GAO) of the admitted and nonadmitted insurance market.

CBO estimates that enacting H.R. 5637 would increase federal revenues by $5 million to $10 million a year over the 2008–2016 period because the bill would prohibit states from collecting taxes on certain insurance products, and that change would in turn reduce federal tax deductions of insurance companies, resulting in higher taxable income for federal purposes. (The bill would have no effect on 2007 revenues because the bill would take effect 12 months after enactment.) The bill would have no significant impact on federal spending because enforcement of the insurance tax system would rest with the states rather than with any federal agency.

By prohibiting states from taxing and regulating certain insurance products issued by companies not based in those states, H.R. 5637 would impose intergovernmental mandates as definded in the Unfunded Mandates Reform Act (UMRA). Although the aggregate costs to state governments of complying with these mandates is uncertain, CBO estimates that they likely would not exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation). The bill contains no new private-sector mandates as defined in UMRA.

Estimated impact on the Federal budget: CBO expects that enacting H.R. 5637 would reduce payments of certain state taxes by insurance companies. These lower payments would, in turn, reduce deductions made by insurance companies for federal taxes and raise taxable income for federal purposes. State governments would likely adjust their finances as a result of these lost revenues. They would likely achieve this through some mix of reduced spending and higher taxes and fees—both deductible and nondeductible. This response by state governments would mute, but not eliminate, the revenue gain to the federal government. CBO estimates that H.R. 5637 would result in an increase in federal revenues of between $5 million and $10 million per year starting in 2008.

H.R. 5637 would require GAO to conduct a study to determine how implementing the provisions of this bill would affect both the admitted and nonadmitted insurance market. Subject to the availability of appropriated funds, the cost of this study would be less than $500,000, CBO estimates.

Estimated impact on state, local, and tribal governments: H.R. 5637 would create a uniform system for taxing and regulating certain types of insurance products. Specifically, the bill would establish national standards for how states may regulate, collect, and allocate taxes for a type of insurance that covers unique or atypical risks—known as surplus lines or nonadmitted insurance. The bill also would establish national standards for how states regulate reinsurance.

Under current law, states use a variety of laws to regulate and tax these products. By preempting such laws and making the state of domicile the only state with regulatory or taxing power, H.R. 5637 contains intergovernmental mandates as defined in UMRA.

Those mandates would result in forgone revenues to the more than 40 states that have a taxing regime different from what would be allowed under the bill.

Specifically, provisions in the bill would:

- Prohibit states from taxing and regulating certain insurance products issued by companies not based in the state;
- Prohibit states from collecting fees from certain brokers of insurance unless states participate in a database of national insurance producers for the licensing of surplus lines brokers and the renewal of those licenses;
- Preempt laws in at least 40 states regarding how insurance policies with multistate risks are taxed and how those taxes are distributed among states; and
- Preempt laws in at least 14 states regarding certain requirements for reinsurance.

Estimated direct costs of mandates to state and local governments

UMRA includes in its definition of the direct costs of a mandate the amounts that state and local governments would be prohibited from raising in revenues as a result of the mandate. The direct mandate costs of H.R. 5637 would be forgone revenues that state governments are currently collecting from taxes on insurance premiums issued by certain out-of-state brokers but would be precluded from collecting under the bill.

CBO estimates that enacting H.R. 5637 would result in state revenue losses that likely would approach but not exceed the threshold established in UMRA ($64 million in 2006, adjusted annually for inflation). While there is some uncertainty surrounding the amount of tax currently being collected by states, the portion of the surplus lines market that would be affected by the regulatory changes in the bill, and the extent of flexibility that would be available to states after enactment of the bill, CBO estimates that forgone revenues would total less than $50 million, annually, beginning one year after enactment. For the purposes of estimating the direct costs of these mandates, CBO considered only the revenues from taxes that industry estimates it is paying and only the revenues that states, as a whole, would no longer be able to collect as a result of the bill.

Other impacts on state and local governments

Over time, CBO expects that states would either join the compact authorized by the bill or change their statutes to reflect the requirements set forth in the bill. Such changes would likely lead to less complexity in the regulation of certain forms of insurance and would mitigate at least some of the tax losses. Such changes, however, could take between three and five years to carry out.

Estimated impact on the private sector: The bill contains no new private-sector mandates as defined in UMRA.

Estimate prepared by: Impact on state, local, and tribal governments: Sarah Puro. Federal revenues: Barbara Edwards. Federal spending: Susan Willie. Impact on the private sector: Paige Piper/Bach.

Estimate approved by: Peter H. Fontaine, Deputy Assistant Director for Budget Analysis; G. Thomas Woodward, Assistant Director for Tax Analysis.

FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds that the Constitutional Authority of Congress to enact this legislation is provided by Article 1, section 8, clause 1 (relating to the general welfare of the United States) and clause 3 (relating to the power to regulate interstate commerce).

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title and table of contents

This section sets forth the title of this legislation—the "Nonadmitted and Reinsurance Reform Act of 2006".

Section 2. Effective date

This section provides that this legislation becomes effective 12 months after date of enactment, except as otherwise specifically provided.

Title I—Nonadmitted Insurance

Section 101. Reporting, payment, and allocation of premium taxes

This section gives the insured's (policyholder's) home State exclusive regulatory and enforcement authority over the collection and allocation of premium tax obligations related to nonadmitted insurance (also known as "surplus lines insurance") for that insured. This section authorizes and strongly encourages the States to enter into a compact or similar process to reallocate the nonadmitted tax premiums collected by insureds' home States among each other in accordance with an appropriate uniform formula. Congress intends this compact or procedure to be adopted within 11 months of the enactment of this legislation and to apply to all subsequently due nonadmitted premium taxes. If a compact or procedure is adopted after the 11 months time period, then Congress intends that the reallocation among participating States apply to premium taxes that are due after the beginning of the next calendar year. This section further establishes the intent of Congress that the NAIC report to the appropriate Congressional Committees identifying the adopted compact or procedures to carry out this section. To facilitate the reallocation of premium taxes, each State may require entities within its domicile procuring nonadmitted insurance to file annual tax allocation reports with that State detailing the portions of premiums attributable to various properties, risks, or exposures located in each state, as necessary to facilitate any reallocation compact or procedures established by the States.

Section 102. Regulation of nonadmitted insurance by insured's home state

This section provides the home State of an insured with the exclusive authority to regulate the placement of nonadmitted insurance with the insured, including the licensure of any surplus lines brokers involved in the placement (although the definition of surplus lines broker in section 106 requires the broker to be licensed in a State to qualify). This section does not limit the ability of States to require that certain business activities taking place within the State be insured through the admitted market, such as State laws requiring workers' compensation insurance to be placed through admitted insurers.

Section 103. Participation in national producer database

This section indicates the intent of Congress that all States participate in the NAIC's national insurance producer database. After two years from the enactment of this legislation, States that do not participate in a national database for the licensure (and license renewal) of surplus lines brokers may not collect any fees relating to the licensing of surplus lines brokers.

Section 104. Uniform standards for surplus lines eligibility

This section streamlines eligibility requirements for nonadmitted insurers. It creates a national eligibility standard for U.S. nonadmitted insurers, preempting State eligibility requirements applying to nonadmitted insurers (that are licensed or authorized in another State) other than section 5A(2) and 5C(2)(A) of the NAIC's NonAdmitted Insurance Model Act. A national standard and listing is created for alien insurers (non-U.S. domestics), allowing States to prohibit a surplus lines broker from placing nonadmitted insurance or procuring nonadmitted insurance from a nonadmitted insurer that is domiciled outside the United States only if the insurer is not on the NAIC International Insurers Department's Quarterly Listing of Alien Insurers.

Section 105. Streamlined application for commercial purchasers

This section provides sophisticated commercial entities with streamlined access to the nonadmitted insurance market. Many States require surplus lines brokers to complete various degrees of due diligence search requirements and documentation to determine if commercial insurance coverage is available in the admitted marketplace before the risks can be covered by nonadmitted insurance. Many States also have exemptions for sophisticated entities to be able to directly access the nonadmitted market. This section allows surplus lines brokers to procure or place nonadmitted insurance for exempt commercial purchasers and preempts State due diligence search requirements if the broker has disclosed to the purchaser that the insurance might be available from the admitted market and that the admitted market may provide greater protection and regulatory oversight and the purchaser then subsequently requests in writing that the broker procure or place nonadmitted insurance.

Section 106. Definitions

This section defines various terms used in Title I, including for the terms admitted insurer, exempt commercial purchaser, home State, independently procured insurance, the NAIC, nonadmitted insurance and the Nonadmitted Insurance Model Act, nonadmitted insurer, qualified risk manager, premium tax, surplus lines broker, and State.

Title II—Reinsurance

Section 201. Regulation of credit for reinsurance and reinsurance agreements

This section establishes a uniform process for credit for reinsurance determinations. If the State of domicile of the ceding insurer is an NAIC-accredited State, or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, then that State determination for credit for reinsurance is controlling and no other State may deny the ceding insurer credit for reinsurance. This section also specifically prohibits non-domiciliary States from applying their own State laws in an extra-territorial manner and preempts actions by States (other than the State of domicile of the ceding insurer) that invalidate arbitration clauses, ignore choice of law determinations, attempt to enforce a reinsurance contract on terms different from those set forth in the contract, or that otherwise apply to reinsurance agreements of non-domiciliary ceding insurers.

Section 202. Regulation of reinsurer solvency

This section gives the State of domicile of the reinsurer sole responsibility for regulating the financial solvency of a reinsurer, as long as such State is accredited by the NAIC. A State that is not officially accredited, but that has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation, is given the same responsibility. This latter provision is intended to give parallel responsibility to the State of New York, which is not accredited by the NAIC, although it currently meets or exceeds such key financial regulation standards required by the accreditation program for appropriate examination authority, minimum capital and surplus requirements, NAIC accounting practices and procedures, and regulation and valuation of investments. Non-domiciliary States may not require reinsurers to provide any additional financial information other than the information required to be filed by the State of domicile. Upon request, a non-domiciliary State may receive a copy of any financial statement filed by the reinsurer with its domiciliary State.

Section 203. Definitions

This section defines various terms used in Title II, including for the terms ceding insurer, domiciliary state, reinsurance, reinsurer, and State.

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