COMPLIANCE ADVISOR

NEW YORK STATE'S IMPLEMENTATION OF THE NONADMITTED AND REINSURANCE REFORM ACT (NRRA)

A PUBLICATION BY

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The following information is intended to provide the Detailed Guidance you will need for a smooth implementation of the NRRA provisions incorporated into New York's Insurance Law. This Compliance Advisor discusses the following NY/NRRA Compliance issues in detail:

1) Home State of the insured
2) New York will tax 100% of written excess line premium
3) The Insured Exempt Commercial Purchaser (ECP) Provision
4) Excess Line Insurer Eligibility Criteria
5) States must join the NAIC National Producer Database or any other National Producer Database by July 21, 2012
6) NRRA Implementation by other states

1) HOME STATE OF THE INSURED

Only one state, the "home state of the insured," is permitted to regulate the placement of any single E&S policy when this provision of the new law becomes effective on July 21, 2011. This means that an excess line broker only has to comply with the home state of the insured's excess/surplus line regulatory requirements: diligent search, due care, disclosure language, affidavit filing, the licensing requirements and premium tax requirements.

This is particularly important when it comes to licensing. The placing broker must have an E&S license in each state which is the "home state" of any insured whose coverage you placed.

In wholesale transactions, the producing, or retail, broker on each such account must have the appropriate license in the "home state of the insured" for each state where placements are made. In New York, this is a "brokers license".

"IDENTIFYING THE HOME STATE OF THE INSURED"

Identifying the "home state of the insured" should be straightforward for 90+% of the placements you make. This is because ELANY statistics suggest more than 95% of all transactions submitted historically are for risks with exposures exclusively in New York. It becomes more challenging when trying to determine the "home state" of a multi-state risk for an affiliated group of entities.

(Generally under a personal lines policy) - the **"home state"** is the state in which the individual insured maintains his/her **"principal residence."** However, if **100%** of the risk is located outside of that state, the "home state" will be the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.

With respect to determining an insured's "home state," New York has added the definition of **"principal residence"** to mean:

(a) the state where the individual resides for the greatest number of days during a calendar year; or

(b) if the insured's "principal residence" is located outside any state, the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated. The law does not specify how the "greatest percentage" is determined.

The most likely scenario you will encounter is a policy which insures a vacation home or other property in another state. If that is the case, such as a New Yorker with a Florida condo, Florida is the home state for such a property policy.

For a "**Commercial insured**" where the insured is a single standalone entity - the "**home state**" of a commercial insured is the state in which the insured maintains its "**principal place of business,**" unless **100%** of the insured risk is located outside that state. In this event, the "home state" will be the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated. Once again, how you determine greatest percentage is not defined.

With respect to determining an insured's "home state," New York has added to the home state definition as follows: An insured's "**principal place of business**" means:

(a) the state where the insured maintains its headquarters and where the insured's high level officers direct, control, and coordinate the business activities; or

(b) if the insured's high level officers direct, control, and coordinate the business activities in more than one state, or if the insured's principal place of business is located outside any state, then the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.

For an "**Affiliated Group**" of insured entities, the "**home state**" is the "**principal place of business**" of the group member to which the largest percentage of premium is allocated.

The term "**Affiliated Group**" means "any group of entities that are all affiliated." [See footnote for the definition of "**Affiliate**"][1].

The NRRA does not address, nor define, "**unaffiliated group**" or "**group policies.**" However, the newly amended New York Insurance Law addresses this type of group policy. Historically, New York law prohibited unaffiliated entities from purchasing property/casualty insurance as a group. Over time, there have been some exceptions carved out of this blanket prohibition, namely with regard to 1) purchasing groups under the National Risk Retention Act; and 2) employer sponsored group personal excess insurance.

The revised New York Insurance Law provides that for these types of unaffiliated "**group**" insureds, the "home state of the insured" will be determined as follows:

- When the group policyholder pays one hundred percent of the premium from its own funds, then the insured's home state is considered the principal place of business of the group policyholder. [This may be the case with many "employer sponsored group excess policies".]

- When the group policyholder does not pay one hundred percent of the premium from its own funds [PG risks], then the home state is that of each group member.

ELANY RECOMMENDATION

The "home state" definition is the driving force of NRRA implementation. ELANY recommends you adjust operational procedures to identify the "home state of the insured" on all accounts, which will incept on and after July 21, 2011. Make sure you have E&S licenses if you conduct business in more than one home state. If you are a wholesaler, you must also verify that your producing broker has the appropriate license in each home state where you do business with such producing broker.

2) NEW YORK WILL TAX 100% OF WRITTEN PREMIUM

New York has decided to tax 100% of each excess line policy's written premium when New York is the "home state of the insured."

All policies with an effective date prior to July 21, 2011 will continue to be subject to existing tax allocation rules on written premiums, additional premiums and return premiums.

All policies effective on and after July 21, 2011 will tax 100% of all written premium when New York is the home state, even when the policy insures risk exposures in other states as well.

ELANY, in conjunction with the New York State Insurance Department, intends to amend the Part A affidavit and the ELANY electronic filing system to guide members through this transition.

[Governor Cuomo's original budget bill and the Assembly's initial budget bill contained provisions to enact the NAIC's tax sharing agreement known as "NIMA". These provisions were deleted due to wide opposition by the industry.]

3) THE INSURED EXEMPT COMMERCIAL PURCHASER (ECP) PROVISION

An Exempt Commercial Purchaser is defined as any person purchasing commercial insurance, that at the time of placement:

A) employs or retains a "**qualified risk manager,**"[2] **and**
B) in the aggregate paid at least $100,000 of property and casualty premium in the immediately preceding 12 months, and
C) meets at least **one** of the following criteria:
- possess net worth greater than $20 million*,
- generates annual revenues in excess of $50 million*,
- employs more than 500 full-time employees or more than 1,000 employees if the insured is an affiliated group,
- is a not-for-profit/public entity organization with $30 million of annual budgeted expenditures*, or

- is a municipality with a population of at least 50,000.

*These items are inflation indexed.

Any insured, which meets the definition of an exempt commercial purchaser, can essentially sign a waiver permitting its excess line broker to access the E&S market without first making a diligent search of the admitted market.

ELANY, in conjunction with New York State Insurance Department, intends to add a question to the Part A and Part C affidavit to identify Exempt Commercial Purchaser transactions. ELANY has recommended to the New York State Insurance Department that a form be drafted and circulated, which will combine the Notice of Excess Line Placement letter with an Exempt Commercial Purchaser waiver into one form for such transactions.

ELANY RECOMMENDATION

For excess line brokers who believe they have a volume of business where insureds qualify as Exempt Commercial Purchasers, identify those insureds now; and adopt a procedure to obtain the necessary signed waiver for new and renewal business incepting on and after July 21, 2011.

4) EXCESS LINE INSURER ELIGIBILITY CRITERIA

The NRRA prohibits states from imposing state specific eligibility requirements upon excess and surplus line insurers [unless nationwide uniform requirements, forms and procedures are developed] other than the following requirements:

- **Alien insurer** [an insurer that is domiciled in another country] will be eligible automatically if it is listed on the NAIC International Insurers Department's Quarterly Listing of Alien Insurers.

- **Foreign insurer** [an insurer that is domiciled in another state or U.S. jurisdiction] will need to meet two substantive requirements under the NAIC Non-Admitted Insurance Model Act. It must i) be "authorized to write in its domiciliary jurisdiction the type of insurance to be placed on an excess line basis, and ii) maintain capital and surplus equal to the greater of $15,000,000 or an amount set by each particular state as the minimum standard for E&S eligibility.

The New York legislation did not incorporate these NRRA eligibility provisions into New York's Insurance law.

The New York State Insurance Department is analyzing changes which will be required to Regulation 41 as a result of these NRRA provisions.

Also, the 12th Amendment to Regulation 41, which will officially reset the minimum capital and surplus requirements for eligibility to $45,000,000 from $15,000,000, is due to be promulgated prior to the NRRA July 21, 2011 effective date.

ELANY is reviewing various options regarding the changes which these NRRA provisions require. What is absolutely certain is that ELANY will continue to evaluate eligible insurers and monitor their financial condition and keep the market place apprised of any situation where a carrier appears to be in a financially hazardous condition.

5) STATES MUST JOIN THE NAIC NATIONAL PRODUCER DATABASE OR ANY OTHER NATIONAL PRODUCER DATABASE BY JULY 21, 2012

The purpose of this provision is to make states fully implement an electronic licensing system for E&S brokers (particularly to expedite issuance of nonresident licenses) by July 21, 2012. If a state fails to implement this process, the NRRA bars such state from charging fees for such licenses.

The foregoing provisions are set forth in the NRRA but not in the New York Insurance Law. Even though they are not expressly set forth in New York's Insurance Law, they, nevertheless, apply to New York.

Currently, the only existing national producer database belongs to the NAIC. There is a potential alternative, which will be created if the NARAB II legislation is passed into law by Congress and signed by the President. The NARAB II legislation would create a not-for-profit corporation, which would function as a clearinghouse for electronically-issued, nonresident producer licenses. If a producer is licensed by its home state, clears a criminal background check and certain other criteria, the producer would pay the licensing fees to the not-for-profit corporation with no other nonresident licensing barriers such as nonresident pre-licensing tests, bond requirements and the like.

6) NRRA IMPLEMENTATION BY OTHER STATES

Only a limited number of states have passed NRRA conforming legislation as of March 31, 2011. A significant number of states have not even introduced a bill to address any aspect of the NRRA.

Notwithstanding inaction by any state, the NRRA mandatory provisions (home state of the insured, ECP exemption, eligibility limitations and joining a national producer database) will go into effect because the federal law supersedes the state laws on these issues. Also, the states are encouraged by Congress to adopt a national uniform system to allocate and share taxes but are not required to do so.

The options currently being considered by various states are as follows:

1) Conforming state law to the NRRA mandates and taxes 100% of the premium on home stated risks (as New York did).

2) Enact SLIMPACT, the interstate compact, which creates a tax sharing clearinghouse and authorizes the adoption of other uniform provisions among compacting states along with other NRRA conforming provisions. Kentucky and Ohio have done this to date, and this legislation is awaiting the Governor's signature in New Mexico.

3) Enact NIMA, the NAIC's tax sharing agreement, and other NRRA conforming language. It appears South Dakota, Mississippi and Wyoming have done this.

CONCLUSION

It is too early to tell how other states will address implementation of the NRRA. It is likely that most states will recognize the mandatory requirements of the NRRA and conform their compliance requirements to it. No tax allocation compact or agreement will be ready for operation by July 21, 2011. While New York is ready to proceed as described in this Compliance Advisor, E&S brokers will have to look to each state for guidance to determine what tax or taxes it will be charged when the NRRA becomes effective on July 21, 2011.

[1] "Affiliate" means: (A) with respect to an insured, any entity that controls, is controlled by, or is under common control with the insured; and (B) an entity has control over another entity if the entity: (i) directly or indirectly or acting through one or more other persons owns, controls, or has the power to vote twenty-five percent or more of any class of voting securities of the other entity; or (ii) controls in any manner the election of a majority of the directors or trustees of the other entity.

[2] "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 - (i)(I) has a bachelor's degree or higher from an accredited college or university in risk management, business administration, finance, economics, or any other field determined by the Superintendent to demonstrate minimum competence in risk management; and (II)(aa) has 3 years of experience in risk financing, claims administration, loss prevention, risk and insurance analysis, or purchasing commercial lines of insurance; or (bb) has (aaa) 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; (bbb) a designation as an Associate in Risk Management (ARM) issued by the American Institute for CPCU/Insurance Institute of America; (ccc) a designation as Certified Risk Manager (CRM) issued by the National Alliance for Insurance Education & Research; (ddd) a designation as a Risk and Insurance Management Society (RIMS) fellow (RF) issued by the Global Risk Management Institute; or (eee) any other designation, certification, or license determined by the superintendent to demonstrate minimum competency in risk management; (ii)(I) has at least seven years of experience in risk financing, claims administration, loss prevention, risk and insurance coverage analysis, or purchasing commercial lines of insurance; and (II) has any one of the designations specified in subclauses (aaa) through (eee) of subitem (bb) of clause (II) of item (i) of this subparagraph; (iii) has at least ten years of experience in risk financing, claims administration, loss prevention, risk and insurance coverage analysis, or purchasing commercial lines of insurance; or (iv) has a graduate degree from an accredited college or university in risk management, business administration, finance, economics or any other field determined by the superintendent to demonstrate minimum competence in risk management.

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