

## **New Law Makes Significant Changes to the Regulation and Taxation of Surplus Line Insurance**

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California [Assembly Bill 315 \(pdf\)](#), signed into law by [Governor Jerry Brown](#) on July 13, 2011, conforms California law to the [Nonadmitted and Reinsurance Reform Act \(NRRA\)](#) that was part of H.R. 4173, the [Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010](#) (signed into law by President Barack Obama on July 21, 2010).

AB 315's provisions became operative on July 21, 2011.

It was important for California to enact AB 315 by July 21, 2011, because the NRRA, which went into effect on that date, pre-empts several aspects of state surplus line insurance regulation and taxation.

The enactment of AB 315 preserves California's authority to regulate surplus line insurance and to collect surplus line insurance taxes.

Here is a summary of key elements of AB 315. The cited sections are the California Insurance Code sections that are added or amended in the [chaptered version of AB 315](#).

### **Home State**

AB 315 introduces the concept of the "home state" of the insured. The concept of home state is especially important for determining whether California law governs a surplus line transaction (1761(a)), whether a producer must obtain a surplus line license (1761(a)), and whether a California tax is imposed on surplus line premiums (1774(a)).

AB 315's description of home state mirrors the provisions of the NRRA.

If an insured is a business, the insured's home state is the state where the insured maintains its principal place of business. If an insured is an individual, the insured's home state is where the insured maintains his or her principal residence. However, if 100% of the insured risk is located outside the state where the insured maintains its principal place of business or principal residence, the home state is the state to which the greatest percentage of the insured's taxable premium for the insurance contract is allocated (1760.1(e)(1)(A)and(B)).

If more than one insured from an affiliated group is named in a single non-admitted insurance contract, the home state is the home state of the member of the affiliated group that has the largest percentage of premium attributed to it under the insurance contract (1760.1(e)(4)). Existing Insurance Code section [1215\(a\)](#) defines "affiliate."

A surplus line broker has the responsibility to determine whether California is the insured's home state (1760.2), and is required to maintain records that verify that the insured is a California home state insured (1768).

### **Premium Tax Payment**

Under pre-AB 315 law, the surplus line insurance tax is imposed on the portion of the premium allocated to risks in California. AB 315 changes that system in order to conform California law to the NRRRA.

AB 315 imposes a tax on 100% of the surplus line insurance premium when California is the home state of the insured (1775.5(b)).

AB 315 includes special transition rules. If a new policy or a renewal policy has an effective date on or before July 20, 2011, and is placed on or before July 20, 2011, the provisions of AB 315 do not apply (1774(d)(3)).

States are allowed to enter into interstate compacts to determine the allocation of surplus line premium taxes. California has not entered into any such compacts.

### **Insurer Eligibility**

AB 315 sets eligibility requirements for a non-admitted insurer that wants to insure California home state insureds.

First, if the insurer is a U.S.-domiciled insurer, the insurer must be licensed to write the type of insurance in its domiciliary jurisdiction and must have a capital and surplus that together total \$45 million.

Second, if the insurer is not domiciled in the U.S., the insurer must be listed on the NAIC International Insurers Department's Quarterly Listing of Alien Insurers (1765.1(a) and (b)).

AB 315 includes detailed requirements that must be met in order to place insurance on a limited basis with an insurer that does not meet the bill's eligibility requirements (1765.1(h)).

AB 315 repeals provisions in Insurance Code section 1765.1 that established the List of Eligible Surplus Line Insurers (LESLI). The bill replaces LESLI with the List of Approved Surplus Line Insurers (LASLI) (1765.2(f)). The requirements of LASLI are substantially the same as the requirements of LESLI. Surplus line insurers that are on LESLI as of July 21, 2011, are automatically on LASLI (1765.1(i)). In order to remain on LASLI, insurers will have to file required documents and pay filing fees (1765.2(c)-(e) and (j)).

### **Commercial Insured**

AB 315 retains the general requirement that a surplus line broker may place business with a non-admitted insurer only after making a diligent search for coverage in the admitted market (1763(a)).

However, AB 315 creates a new exception to the general requirement. The diligent search requirement does not apply to a commercial insured (1763(h)).

In order to qualify as a commercial insured, an insured must employ or retain a qualified risk manager, must have paid nationwide commercial property/casualty insurance premiums in excess of \$100,000 in the immediately preceding 12 months and must meet one of five listed criteria which include minimum standards relating to net worth, revenues and number of employees (1760.1(b)). The surplus line broker is responsible for ensuring that an applicant for insurance is a commercial insured (1763(h)(2)).

### **Administrative Services**

AB 315 allows a California domiciled insurer to have common directors with an affiliated non-admitted insurer and permits a California domiciled insurer to perform administrative services for an affiliated non-admitted insurer (1761(b)).