IS SLIMPACT LOSING STEAM? TENNESSEE SWITCHES TO NIMA

By John Pitblado

As part of the passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act[1] ("Dodd-Frank") in July, 2010, Congress incorporated the Nonadmitted Insurance and Reinsurance Reform Act ("NRRA"),[2] which provides that nonadmitted insurance will be subject to regulation only in an insured's home state, and premium tax and other regulatory requirements may not be imposed by any other state.

Regarding allocation of non-admitted premium tax, and centralized administration of the Act, the NRRA identifies a problem but reserves authority to the states the authority to "fix" the problem through voluntarily arrangements: "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."[3]

In response, two competing approaches to shared governance were adopted: (1) the Surplus Lines Insurance Multi-State Compliance Compact ("SLIMPACT"), which is supported by The National Conference of Insurance Legislators ("NCOIL"), The Council of State Governments ("CSG"), and the National Conference of State Legislatures ("NCSL"); and (2) the Non-Admitted Insurance Multi-State Association, Inc. ("NIMA"), which is supported by the National Association of Insurance Commissioners ("NAIC"). Each approach attracted a few states to join, while the majority of states remain unaffiliated with either. While SLIMPACT addresses a number of issues in the non-admitted market, including premium taxes, NIMA is limited to premium tax issues.

However, Tennessee recently withdrew from SLIMPACT, and joined NIMA (along with Wisconsin), and in doing so may tip the balance as to which approach (if either), likely will prove to last. Following is a brief review of the competing models, and issues and concerns with both models. Time will tell which will last, if either, but recent events cloud SLIMPACT's future. Moreover, given that the major non-admitted premium states remain on the sidelines, declining to participate in either model, there is serious doubt that either model will solve the problem identified by Congress, which may result in Congress deciding that leaving it to the states to "fix" the problem is not a viable option.

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1 Dodd-Frank, Public Law 111-203, is codified in various sections of the United States Code.

2 15 U.S.C. § 8201 *et seq*.

3 15 U.S.C. § 8201(b).

SLIMPACT

According to the draft model promulgated by the NCSL,[4] SLIMPACT's stated purposes are:

> 1. To implement the express provisions of the NRRA.
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> 2. To protect the Premium Tax revenues of the Compacting States through facilitating the payment and collection of Premium Tax on Non-Admitted Insurance. . . .
>
> 3. To streamline and improve the efficiency of the surplus lines market by eliminating duplicative and inconsistent tax and regulatory requirements among the States. . . .
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> 4. To streamline regulatory compliance with respect to Non-Admitted Insurance placements by providing for exclusive single-state regulatory compliance for Non-Admitted Insurance of Multi-State Risks, in accordance with Rules to be adopted by the Commission. . . .
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> 5. To establish a Clearinghouse for receipt and dissemination of Premium Tax and Clearinghouse Transaction Data related to Non-Admitted Insurance of Multi-State Risks. . . .
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> 6. To improve coordination of regulatory resources and expertise between State insurance departments and other State agencies, as well as State surplus lines stamping offices, with respect to Non-Admitted Insurance.
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> 7. To adopt uniform Rules to provide for Premium Tax payment, reporting, allocation, data collection and dissemination for Non-Admitted Insurance of Multi-State Risks. . . .
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> 8. To adopt uniform mandatory Rules with respect to regulatory compliance requirements for: (i) foreign Insurer Eligibility Requirements; (ii) surplus lines Policyholder Notices.
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> 9. To establish the Surplus Lines Insurance Multi-State Compliance Compact Commission.
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> 10. To coordinate reporting of Clearinghouse Transaction Data. . . .

[4] *See* NCOIL, SLIMPACT Model (Available at: http://www.ncsl.org/documents/standcomm/sccomfc/SLIMPACT.pdf) (2010)

> 11. To perform these and such other related functions as may be consistent with the purposes of the Surplus Lines Insurance Multi-State Compliance Compact.

Id.

SLIMPACT, by its terms, becomes effective upon the earlier of the compact's adoption by ten states or states representing 40% of the surplus lines U.S. market share. The clearinghouse and tax allocation implementation occurs on the first January 1 or July 1 following the first anniversary of the date the commission becomes effective.[5] The nine states that enacted approving legislation to join SLIMPACT are Kentucky, New Mexico, North Dakota, Indiana, Kansas, Vermont, Rhode Island, Alabama, and Tennessee. Tennessee was the last state to join SLIMPACT, in June, 2011. At the time, it was anticipated that a tenth state would soon follow, and trigger the compact commission's effective date. However, Tennessee recently withdrew its approving legislation,[6] bringing SLIMPACT's membership back down to eight states.

NIMA

According to its own description:

> NIMA, Inc. provides a mechanism to report, collect, allocate and distribute surplus lines tax revenues consistent with the NRRA. The NRRA is part of the Dodd-Frank Wall Street Reform legislation passed in 2010 that allows only the home state of the insured to require premium tax payments for nonadmitted insurance in the absence of an agreement among states. NIMA, Inc. will allow participating states to continue to collect surplus lines premium taxes according to state laws consistent with the Agreement. [7]

NIMA generally applies to property and casualty insurance, consistent with the NRRA, but allows a state to utilize the clearinghouse for non-property and casualty insurance too.[8] NIMA also defines "principal place of business" and "principal residence" for the purpose of the definition of an insured's "home state", and provides that if the insured's principal place of

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[5] *See* Executive Summary by the National Association of Professional Surplus Lines Offices, Ltd. (NAPSLO) (available at: http://www.napslo.org/imispublic/PDF/Legreg/SLIMPACT_ExSum92807.pdf)

[6] Tenn. Code Ann. § 56-14-201 (2014) (withdrawn by S.B. 356, signed into law April 4, 2014, effective July 1, 2014).

[7] *See* NIMA Press Release (available at: http://www.floir.com/siteDocuments/NIMAPressRelease05082014.pdf) (May 8, 2014)

[8] *See* Draft NIMA Agreement (available at: http://www.floir.com/siteDocuments/NIMA07122011.pdf).

business or principal residence is located outside the United States, then the insured's home state is the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated.[9] A state may withdraw from NIMA by providing 60 days written notice. NIMA members include Florida, Louisiana, South Dakota, Utah, Wyoming and Puerto Rico, and, now, two new "associate" (trial period) members, Wisconsin and Tennessee.[10]

Challenges for Both Models

The challenge in centralizing interstate taxation and regulation is analogous to the challenge inherent in federalism. The NRRA reserves state authority regarding insurance regulation in line with the long-standing and entrenched model of state regulation of insurance as embodied in the McCarran-Ferguson Act.[11] The NRRA thus leaves it to the states to develop a means to act in uniformity, in order to create efficiency gains that will be beneficial both to the States' tax revenue and to consumers.

Generally, SLIMPACT is the more "federal" model. It is an interstate compact, whereas NIMA is a contractual arrangement. SLIMPACT creates a commission with regulatory authority. NIMA has no commission and strives to avoid the imposition of any central authority, instead reserving maximum authority to the state commissioners.

The authors of SLIMPACT argued its benefits in a letter to the states soon after it was formed in 2011:

> Unlike other existing proposals, SLIMPACT-Lite has been developed and vetted over the course of several years and is fully responsive to Dodd-Frank Act provisions. It would authorize a governing commission to establish allocation formulas, uniform payment methods and reporting requirements, insurer eligibility standards, and a single policyholder notice to replace the various forms used across the country. To streamline taxation and ensure that each state receives its fair share under SLIMPACT, each state would create a single tax rate for surplus lines insurance, charge their own rates on multi-state risks, and choose among uniform payment dates. . . .

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9 *Id*.

10 *See* NIMA Press Release (available at: http://www.floir.com/siteDocuments/NIMAPressRelease05082014.pdf) (May 8, 2014).

11 *See* Crawford, Zackary "Allocating Tax and Power: An Examination of the Non-Admitted and Reinsurance Reform Act," B.U. Law Rev. 94:305, at 312 ("Ever since McCarran-Ferguson, states have generally been the chief regulators of insurance. The industry and the states have entrenched and coordinated their behavior based on this assumption. Moreover, the states still vigorously lobby to protect their primacy in this area of law. Dodd-Frank's creation of the FIO in 2010 was controversial for this reason. Though the statutory provision creating the FIO states that the office does not have any regulatory power, states still fear that Congress has begun a march toward enhanced federal regulation.")

> Making matters more pressing is the evolving federal threat of preemption. The new Federal Insurance Office (FIO)—in its study on how to modernize and improve insurance oversight—may use any failure by the states to implement reform to push for a greater federal role in the historically state-regulated industry. With this new insurance presence in Washington, state modernization efforts will be more closely scrutinized than ever before.[12]

However, some have questioned the constitutionality of a compact that cedes a state legislature's substantive rule-making authority to a commission or other non-governmental or quasi-governmental body.[13] The NAIC expressed its concerns with SLIMPACT early on, suggesting that SLIMPACT's central commission could preempt state law in ways not necessarily required by the NRRA, and its governance structure would be overly complicated, with an Executive Committee required to be comprised of individuals in the surplus lines business, including insurance industry professionals, law firms, regulators and surplus lines stamping offices.[14]

Constitutional concerns are interesting and create potential legal issues, but nevertheless, maximizing premium tax revenue is more likely where the rubber hits the road for most states. As one author described, in recounting the history of state regulatory authority in the arena of non-admitted insurance, and one of the driving forces behind the passage of the NRRA:

> Once a state permitted purchase of nonadmitted insurance, states avoided revenue loss by taxing the policy premiums themselves. Such taxation is simple and uncontroversial for policies where all of the risk is located within one state. In contrast, taxation of multistate risk policies proved to be enormously complicated and controversial. States developed different, incompatible, and even collectively unfair schemes to tax such policies. The rationale was equitable: each state taxed the premium based on how much of the risk was located within its jurisdiction. Different states, however, had different tax and risk allocation formulas, with some jurisdictions having no taxation allocation laws at all, and many states having different tax schedules. This complexity notwithstanding, there was also little to no guidance on which state's formula applied to a given policy. . . . Consequently, in the realm of multistate nonadmitted insurance, leaving coordination to over fifty jurisdictions did not yield efficient outcomes.

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12 *See* Jan. 7, 2011 letter to National Council of Insurance Legislators (available at: http://www.ncsl.org/research/financial-services-and-commerce/letter-to-state-legislative-leaders-on-slimpact.aspx)

13 *See* McCarty, Kevin "In My Opinion: Why Florida Chose NIMA" (available at: http://www.propertycasualty360.com/2011/07/27/in-my-opinion) (July 27, 2011).

14 *See* NAIC position statement regarding creation of Surplus Lines regulatory authority (available at: http://www.naic.org/index_financial_reform_surplus_lines.htm).

Crawford, *supra*, at 314-15

The NRRA was created precisely for the purpose of realizing efficiency gains by moving away from the 50-state patchwork model. As a result of its more complicated and centralized governance structure, SLIMPACT may not realize the same efficiency gain as the more stripped-down regulatory structure of NIMA. Some commentators have suggested that even NIMA adds too much cost to the existing structure by creating and staffing a clearinghouse that, without greater participation, may not warrant its cost.[15]

NIMA Creates "Associate Member" Status to Attract Participation

In touting efficiency gain and less centralized authority, NIMA has recently begun luring states by allowing them "associate" membership, which allows them to essentially take a trial look at NIMA's efficiency benefits, without any cost to the state. While the "associate" members do not receive tax allocations, their premium figures are included in the NIMA allocation database, which allows them to model what their actual allocation would be.[16] However, since associate members do not participate in the tax allocation process, associate members do not advance a resolution of the problem identified by Congress.

Apparently, the enticement worked. NIMA announced in a May 8, 2014 press release that Tennessee and Wisconsin have joined as "associate" member states.[17] Flexing its muscle, and touting its status as "the only functioning uniform Nonadmitted and Reinsurance Reform Act (NRRA) clearinghouse in the nation," NIMA notes that "[s]ince the implementation of the Clearinghouse on July 1, 2012 and as of May 7, 2014, NIMA, Inc. members have allocated more than $1.077 billion in premiums and generated more than $50 million in taxes."[18] NIMA also appears confident that California will join.[19] Yet, California has not yet joined NIMA.

Is the Sun Setting on SLIMPACT?

SLIMPACT has clearly lost momentum, and it may prove to be a fatal blow that Tennessee withdrew to join NIMA. Tennessee, after all, was the last state to join -- back in

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15 *See* Brown, Richard "Surplus Lines Analysis: Multistate Clearinghouse Economics Don't Work" Insurance Journal (available at: http://www.insurancejournal.com/news/national/2012/02/27/237328.htm) (Feb. 27, 2012).

16 *See* NIMA Associate Member Brochure (available at: http://www.floir.com/siteDocuments/NIMAAssociateMembershipBrochure.pdf).

17 *See* NIMA Press Release (available at: http://www.floir.com/siteDocuments/NIMAPressRelease05082014.pdf) (May 8, 2014).

18 *Id.*

19 *See* Sean Carr, *supra*.

2011, as SLIMPACT then stood on the precipice of its self-imposed ten state threshold to become effective. But its momentum stalled, and now it is one state farther away from meeting its threshold, while NIMA has attracted an increasing, if still relatively small "market share" of governance over non-admitted premium tax dollars. Perhaps SLIMPACT will ultimately merge with NIMA in some fashion.[20]

However, at this point, the major non-admitted premium states have not joined either SLIMPACT or NIMA,[21] and Congress, already dissatisfied with the lack of progress by both may ultimately run out of patience and step in.

In the meantime, industry eyes will increasingly turn towards NIMA. If Tennessee and Wisconsin see results and become full members, it may build enough momentum to bring California on board, or cause a merger with the SLIMPACT states. ReinsuranceFocus.com will continue to stay abreast of these and other developments in the implementation of the NRRA.

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John Pitblado is an associate with CARLTON FIELDS JORDEN BURT P.A., resident in its Hartford, Connecticut office.

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[20] According to Merle Scheiber, South Dakota's Insurance Director and NIMA proponent, "NIMA and SLIMPACT representatives are continuing to work on a plan to potentially join their operations. . . The core of an agreement would be to connect SLIMPACT states' premium allocation method to NIMA's clearinghouse infrastructure. The Surplus Lines Clearinghouse, an arm of the Florida Surplus Lines Service Office, provides some tax services for NIMA states and some nonmembers, including California." See Carr, Sean P., "California, another state contemplate joining surplus lines pact," SNL Risk and Regulation (available at: http://www.snl.com/InteractiveX/Article.aspx?cdid=A-25279564-11307 (Oct. 2, 2013). *See also*, Carr, Sean "Surplus Lines Pacts Plot Comebacks Amid Industry Skepticism" Insurance Record (available at: http://www.insurancerecord-digital.com/insurancerecord/20131003?pg=13#pg13).

[21] NIMA's Surplus Lines Clearinghouse release a report on July 8, 2013, detailing what non-participating states would be allocated under its formulas. The table makes clear that the Texas ($33,601802), California ($23,471,429), Georgia ($16,434,613), Illinois ($12,838470) and New York ($12,436,908) account for nearly 40% of those premium dollars (which total $252,202,022). See NIMA Surplus Lines Clearinghouse Allocated Premiums Report (at: http://www.floir.com/siteDocuments/NIMASLClearinghouseAllocatedPremiumsNon-NIMA07082013.pdf) (July 8, 2013)