I've been asked to speak on the topic of surplus lines tax that this committee has been asked to study.

"Surplus Lines" insurance is a line of insurance provided by insurers who are authorized to do business in the state, but are not licensed in the state. These non-admitted insurers write insurance on risks who cannot obtain coverage from admitted insurers… (they usually write insurance on risks other insurance companies are not willing to insure…for example…a dynamite factory, or a movie studio in Wilmington…or, more common:…a nursing home…)

The Dodd-Frank Financial Reform Act is a major financial reform law that was passed by Congress. It is a huge piece of legislation, but the part that we are focused on today is the part that included surplus lines insurance reforms that attempt to make the regulation of the surplus lines market in the various states more efficient and more uniform on a national basis.

The new law is expected to increase the level of efficiency in purchasing surplus lines insurance for all those involved in the surplus lines transaction..from the insurance company to the brokers to the consumers.

That is a good intention but, unfortunately, the law included a provision that makes things a little more difficult for the states. Prior to July 21, 2011, surplus lines brokers paid the surplus lines taxes to each state where the insured company had covered property in addition to the insured's home state based on the insurance premiums generated in each state. As you can imagine, that created multiple calculations, different applicable tax rates, multiple state licensing, etc. and the brokers wanted out of that task and increased efficiency in the process and lobbied for this change. So, beginning on July 21, 2011, the surplus lines brokers are to pay the state of the "insured's principal place of business", the "Home State" of the insured, all of the surplus lines tax from all the business that surplus lines company does all around the country. This was done to make it easier for surplus lines brokers who were having to figure out where to pay the tax. So..that movie production company that has a big operation in Wilmington, but has California as its home state will pay ALL of its surplus lines tax to California from now on and zero to North Carolina. To protect us as much as possible, the General Assembly passed a law in the last session (Spring of 2011) to ensure that North Carolina will keep 100% of the tax on North Carolina's home state insured companies that have multi-state locations.

The role of the Department of Insurance is simply to collect available surplus lines taxes. We immediately turn it over to the state General Fund. We have one employee who handles this estimated 25 million dollars collected each year.

We know that before July 21, 2011, North Carolina collected 5% of about 500 million, or about $25 million dollars per year in surplus lines taxes. This is from businesses and individuals domiciled in North Carolina, and from businesses doing business in North Carolina, but domiciled in another state (the movie production company, for example). We are like every other state in that we don't know how much of that money came to the state from out of state companies doing business in North Carolina versus how much came from companies domiciled in North Carolina, because we have never needed to collect that data before.

We will be able to compare our fourth quarter tax intake this year to last year to be able to give a better estimate. The final fourth quarter collection figures should be known to us in February, 2012. After that time, we'll be able to see if there has been a drop off and, if so, how much it has been. We anticipate there will be a reduction in surplus lines tax collected because North Carolina has fewer domiciled companies with multi-state exposures when compared to many other states.

The new federal law allows the states to just sit tight if they choose to and collect 100% of all surplus lines tax the state collects from premiums paid by domestic companies. Or, if a state would like to, the Dodd Frank Act says that if the states want to share the tax amongst themselves they can do so by working it out amongst themselves. You can imagine how well that has gone. No agreement or compact is up and running at this time.

Two possible interstate compacts have been trying to get off the ground. Both compacts would provide an agreement by which the states who join the compact could share the tax income. One agreement or compact choice is led by NCOIL (the National Conference of Insurance Legislators) and one by NAIC (the National Association of Insurance Commissioners). The NCOIL version needs 10 states to become operational, but thus far only has nine states that have joined: Alabama, Indiana, Kansas, Kentucky, New Mexico, North Dakota, Rhode Island, Tennessee and Vermont. The NAIC version has 12 states who have joined: __________The NAIC version The NIMA plan is a more "slimmed down version" of how to proceed. It focuses mainly on dividing the tax. The NCOIL version is broader. It has a bigger regulatory role and some states felt that joining that compact gave up too much of the states power to decide certain issues.

So…this committee was charged in SB 321, sponsored by Sen. Apodaca (House version sponsored by Rep. Dockham), with trying to figure out the best plan for North Carolina to be able to keep the most surplus lines tax revenue possible. SB 321 tasked this committee with recommending to the full General Assembly whether North Carolina should join a compact, and, if so, which compact. This committee is to report its findings, recommendations, and any proposed legislation to the 2012 session of the General Assembly.

As of today, neither interstate compact or agreement is up and running. NCOIL testified to Congress in the past few months that they would work to merge their agreement with the NAIC agreement, but..that has not happened as of yet. So, many states, including the larger states, have not acted yet to determine which compact or agreement, if any, they will enter. If the General Assembly decides it would be best for North Carolina to join a compact, North Carolina would benefit most from being in the compact or agreement that the most states, particularly the larger states from which we receive the most money, join. We will not know that until more time passes. We will not have final fourth quarter data for 2011 collected until after the New Year. We have just received third quarter data. At that time we can compare the third and fourth quarters and be able to tell what change in income the state has had. That will at least provide a basis for estimating the impact on revenue and possibly indicate how the state would be benefit through joining a compact and hopefully, the compact options will have more clarity by then.

The NAIC is meeting in Washington D.C. as we speak today and the Commissioner is with them. A committee is dedicated to that issue and the Commissioner will bring back those reports with him when he returns. From speaking with the Chair of that committee, the Commissioner of Louisiana yesterday, the Commissioner learned that the NAIC is going to try to persuade the SLIMPACT states to join the NAIC version at least until and if SLIMPACT gets up and running.

As of now, the largest states..the states from whom a state might expect to receive the most tax, have not joined either compact. Those states are New York, Texas and California.

Also according to the latest information we've been able to obtain the two compacts, NIMA and SLIMPACT, were working together to make their plans more like each other. They may make their allocation schedules similar.

So…at this point, a summary of the two compacts and their characteristics would not be the best use of time today because the compacts are changing.   We will continue to follow this and keep you updated.

I think the plan of the chairs is to use this meeting to set out the issue for you and then to revisit this issue at a later meeting so that this committee will have more data to use to try to recommend action to the General Assembly. I hope the information I've presented today will be helpful to you.