



COMMONWEALTH OF KENTUCKY  
DEPARTMENT OF INSURANCE  
Frankfort, Kentucky

**ADVISORY OPINION  
2011-04**

**The following Advisory Opinion is to advise the reader of the current position of the Kentucky Department of Insurance (the “Department”) on the specified issue. The Advisory Opinion is not legally binding on either the Department or the reader.**

TO: ALL SURPLUS LINES BROKERS TRANSACTING NON-ADMITTED  
INSURANCE ON MULTI-STATE RISKS

FROM: SHARON P. CLARK, COMMISSIONER  
KENTUCKY DEPARTMENT OF INSURANCE

DATE: JUNE 3, 2011

RE: NON-ADMITTED INSURANCE ON MULTI-STATE RISKS – HB 167

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The 111<sup>th</sup> United States Congress enacted the Non-Admitted and Reinsurance Reform Act of 2010, Title V, Subtitle B of the Dodd-Frank Wall Street Reform and Consumer Protection Act, referred to hereinafter as NRRRA. NRRRA established certain rules and requirements regarding the placement of non-admitted insurance business on multi-state risks. In particular, NRRRA specified that no state, other than the Home State of an insured, may require any premium tax payment for non-admitted insurance. NRRRA further suggested that each state adopt nationwide uniform requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for non-admitted insurance. NRRRA becomes effective July 21, 2011.

During the 2010 Kentucky General Assembly, HB 167 was enacted. This bill authorizes the State of Kentucky to become a Compacting State and to comply with the

rules and requirements established by the Surplus Lines Insurance Multi-State Compliance Compact Commission (the “Commission”).

Sections 2, 3, and 4 of HB 167 amend provisions of KRS 91A.080, KRS 136.392 and 304.10-180 to establish one uniform tax rate that would apply to non-admitted insurance on multi-state risks. This uniform tax rate is in lieu of separate taxes imposed by local governments, the Kentucky Revenue Cabinet, and the Department of Insurance. Section 5 of HB 167 provides that Sections 2, 3, and 4 of the bill will take effect only upon the following:

1. Legislative enactment of the compact into law by two compacting states; and
2. The Commission becomes effective, which shall occur when:
  - a. There are a total of ten compacting and contracting states; or
  - b. There are compacting and contracting states representing greater than 40% of the surplus lines insurance premium volume based on records of the percentage of surplus lines insurance.

At the time of publication of this Advisory Opinion, Sections 2, 3, and 4 are not effective and are not expected to become effective by June 8, 2011, the date that most legislation passed by the 2010 Kentucky General Assembly will be effective. Consequently, this Advisory Opinion clarifies the Department’s expectations up to and until Sections 2, 3, and 4 of HB 167 become effective. This Advisory Opinion also outlines those provisions of NRRA that preempt current Kentucky state law governing non-admitted insurance on multi-state risks.

After July 21, 2011, NRRA preempts the following provisions of Kentucky law:

1. Home State

NRRA provides that the placement of non-admitted insurance shall be subject to the statutory and regulatory requirements solely of the insured’s Home State<sup>1</sup>.

This provision of the NRRA prevents the Kentucky Department of Insurance from applying provisions of KRS Chapter 304, Subtitle 10 to non-admitted insurance or surplus lines transactions where Kentucky is not the Home State of the insurance risk. Rather, the statutory and regulatory requirements of the insured’s Home State will govern these transactions.

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<sup>1</sup> Home State is defined as (1) the state in which an insured maintains its principal place of business or, in the case of an individual, the individual’s principal residence or (2) if 100% of the insured risk is located outside of the principal place of business or resident state, the state to which the greatest percentage of the insured’s taxable premium for that insurance contract is allocated.

## 2. Licensure Requirements

NRRA provides that no state, other and an insured's Home State, may require a surplus lines broker to be licensed in order to sell, solicit, or negotiate non-admitted insurance with respect to such insured.

Kentucky law at KRS 304.10-040 provides that if certain insurance coverages cannot be procured from authorized insurers, such coverage may be procured from unauthorized (or non-admitted) insurers provided the insurance must be procured through a licensed surplus lines broker. KRS 304.10-040 is preempted by NRRA to the extent that Kentucky can no longer require a surplus lines broker license where Kentucky is not the "Home State" and where the non-admitted insurance risk is only partially located in Kentucky.

## 3. Exempt Commercial Purchaser

NRRA provides that a surplus lines broker seeking to procure or place non-admitted insurance in a state for an exempt commercial purchaser<sup>2,3</sup> shall not be required to satisfy any state requirement to make a diligent search to determine whether the full amount or type of insurance sought by such exempt commercial purchaser can be obtained from admitted insurers if:

- a. 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
- b. The exempt commercial purchaser has subsequently requested in writing the broker to procure or place such insurance from a non-admitted insurer.

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<sup>2</sup> An "exempt commercial purchaser" is defined by the NRRA as any person purchasing commercial insurance that, at the time of placement, 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 possess a net worth in excess of \$20 million, as adjusted in accordance with the footnote 3;
  - ii. The person generates annual revenues in excess of \$50 million, as adjusted in accordance with footnote 3.
  - iii. The person employees more than 500 full-time equivalent employees per individual insured or is a member of an 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 million, as adjusted in accordance with footnote 3; or
  - v. The person is a municipality with a population in excess of 50,000 persons.

<sup>3</sup> Adjustment: Effective on the fifth January 1 occurring after the date of the enactment of [the NRRA] and each fifth January 1 occurring thereafter, the amounts in c.i, c.ii, and c.iv. of footnote 2 above shall be adjusted to reflect the percentage change for such 5-year period in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics of the U.S. Department of Labor.

Kentucky law, at KRS 304.10-040(2) requires that a diligent effort be made to procure insurance on all risks from among the insurers authorized to transact and actually write that kind and class of insurance before an insurance risk may be procured from the non-admitted market. To the extent that a prospective insured meets the definition of an exempt commercial purchaser, Kentucky's due diligence requirement in 304.10-040 is preempted.

Further, Kentucky law at KRS 304.11-020(2)(c) provides a definition of an exempt commercial *policyholder*. The definitions of an exempt commercial purchaser under the NRRA and an exempt commercial policyholder under Kentucky law differ slightly. To the extent that an insured meets the definition of an exempt commercial purchaser under the NRRA, federal law will govern the multi-state non-admitted insurance transaction covering the exempt commercial policyholder. In this event, the surplus lines broker placing the coverage shall comply with the taxation requirements applicable to other multi-state non-admitted insurance transactions.

#### 4. Taxation on Non-Admitted Insurance on Multi-State Risks

NRRA provides that the placement of non-admitted insurance shall be subject to the statutory and regulatory requirements solely of the insured's Home State.

Kentucky law, at KRS 304.10-180, provides that each surplus lines broker shall pay a 3% surplus lines tax, a premium surcharge tax in accordance with KRS 136.392, and local government premium taxes in accordance with KRS 91A.080 on surplus lines insurance placed with an unauthorized insurer. KRS 304.10-180(2) provides that if a surplus lines policy covers risks or exposures only partially in the State of Kentucky, the tax payable shall be computed upon the proportion of the premium which is properly allocable to the risks or exposures located in Kentucky. To the extent that Kentucky is not the "Home State," the taxes imposed by KRS 304.10-180 are preempted. However, where Kentucky is the Home State, the taxes imposed by KRS 304.10-180 are applicable on the premium associated with the entire multi-state risk. KRS 304.10-180(2) related to the apportionment of premium on multi-state risks is preempted by NRRA in its entirety.

Section 1, Article IV of HB 167 provides that each compacting state may charge its own rate of taxation on the premium allocated to such state based on the applicable Allocation Formula provided that the state establishes one single rate of taxation applicable to all non-admitted insurance transactions on multi-state risks. When the Commission becomes effective, Sections 2, 3, and 4 of HB 167 establish one tax rate of 11.8% applicable to non-admitted insurance on multi-state risks. The surplus lines broker will be required to collect this tax and remit it to the Department of Insurance.

Questions regarding this Advisory Opinion may be directed to the Property & Casualty Division at (502) 564-6046.

/s/ Sharon P. Clark.  
Sharon P. Clark, Commissioner  
Kentucky Department of Insurance  
On this 3<sup>rd</sup> day of June, 2011