

Locke Lord QuickStudy: Surplus Lines Task Force Discusses Modernizing the Nonadmitted Insurance Model Act and the Standard Form of Trust Agreement

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On November 18, 2020, the Surplus Lines Task Force held a virtual meeting in lieu of its meeting at the 2020 NAIC Fall National Meeting. The Task Force discussed the proposed modernization of the NAIC Nonadmitted Insurance Model Act (Model 870) (the “Act”) and the Standard Form of Trust Agreement.

Nonadmitted Insurance Model Act

The Task Force formed a drafting group to review the Act, which has been adopted by 31 states, and have it conform to the changes provided for under the federal Nonadmitted and Reinsurance Reform Act of 2010 (the “NRRA”). There was a discussion as to whether the Task Force should open up the Act to a more robust review, but this was tempered by the fact that further analysis of other provisions of the Act could delay or even derail the process.

The drafting group’s recommendations included a number of surplus lines insurance issues, including incorporating provisions related to affiliated/nonaffiliated groups to bring the Act in line with the current law of states that have adopted the NRRA. With respect to group insurance policies, the NRRA addresses policies covering affiliated groups, but not nonaffiliated groups, such as a risk purchasing group or policies issued by a risk retention group. By way of background, the NRRA expressly defines “home state” as the state where the insured maintains its principal place of business, or where the majority of the taxable premium is located if 100% of the risk is outside of the state where the principal place of business resides. The NRRA specifically addresses how to determine the principal place of business of an affiliated group, by looking to the state of the largest group member as determined by percentage of premium attributed to the members. However, the NRRA does not address how to determine the home state of an unaffiliated group. This has led to ambiguity on how to structure group insurance products in the surplus lines insurance market for nonaffiliated groups, such as whether and where declinations are required or where premium taxes need to be paid. The changes will look to incorporate the group requirements.

In addition, the drafting group recommended that the Act incorporate accident and health insurance policies in light of the growing acceptance of the ability of surplus lines insurers to write such risks and on the heels of the Task Force’s adoption of the Guidelines on Nonadmitted Accident and Health Coverages issued in 2019. The purpose of the Guidelines was to assist states in updating state laws and to establish procedures to permit accident and health insurance coverage to be produced in the surplus lines insurance market. The Guidelines

highlighted that the types of accident and health insurance coverage that some states are permitting in their nonadmitted market include short term medical, international major medical, excess disability, high-risk disability and other similar insurance coverages.

In addition, areas recommend for updating the Act included (1) adding the concept of domestic surplus lines insurers (DSLIs), (2) revising the surplus lines insurance eligibility requirements to incorporate the minimum standards provided for under the NRRA for both foreign and alien surplus lines insurers, (3) eliminating the allocation of premium for tax sections as these was replaced with the “home state” system under the NRRA, (4) including provisions related to self or independent procurement of insurance tax, where the insured goes out of its home state to purchase insurance, and (5) adding the concept of exempt commercial insurance purchasers, where a surplus lines insurance broker does not need to satisfy the diligent search requirements for insureds that satisfy the definition of an exempt commercial insurance purchaser.

Following the discussion, the Task Force agreed to proceed with a formal review and to modernize the Act.

Standard Form of Trust Agreement

The Task Force also discussed a change to the standard form of Trust Agreement utilized by alien insurers when they qualify for inclusion on the Quarterly Listing of Alien Insurers with the NAIC. A trust fund is required and must be consistent with the NAIC’s International Insurers Department requirements for such a trust.

The NAIC Legal Division issued a memorandum recommending that the Task Force consider revisions to the Trust Agreement to provide greater flexibility for the termination of the agreement in those cases where there are practically no present or future liabilities to the trust. The Legal Division noted that revisions to be considered include permitting termination upon: (1) a Statement of Actuarial Opinion or report of certified public accountant to the effect that there are no reserves applicable to the Trust, (2) that the company has taken reasonable steps to insure the payment of present or future claims; e.g., the entry into a 100 percent Quota Share Reinsurance Agreement, or (3) discretion by the IID to provide recommendations to the Trustee on the termination of the Trust based upon unique fact occurrences.

The Legal Division also recommended that the Task Force consider revisions to other sections within the Trust Agreement, including (1) Article 1, Definitions, for updating and deleting, where necessary, (2) Article 2.8, Letters of Credit, for review of the language surrounding the use of letters of credit, (3) Article 3.7, Trustee’s Fees and Expenses, regarding the amounts listed therein, and (4) the use of Certified Mail provided for throughout the document.

The Task Force agreed to move forward with the specific review and draft amendments to the standard form of Trust Agreement.

Locke Lord will continue to monitor these developments.

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