



STATE OF ARIZONA
DEPARTMENT OF INSURANCE

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CHARLES R. COHEN
Director of Insurance

CIRCULAR LETTER 2000-9

TO: Insurance Rating Organizations; Insurance Industry Representatives; Insurance Trade Associations; Property & Casualty Insurers; and Other Interested Parties

FROM: Charles R. Cohen
Director of Insurance

DATE: June 5, 2000

RE: **House Bill 2016; Surplus Lines Insurance**

The Arizona Department of Insurance (Department) administers the Arizona Revised Statutes, Title 20, Chapter 2, Article 5, governing the transaction of surplus lines insurance (SL) in Arizona. The purpose of this Circular is to inform you of changes made to the SL law by House Bill (HB) 2016, effective July 18, 2000.

Prior to the enactment of HB 2016, nonresidents were not eligible for a surplus lines broker's (SLB) license in Arizona except for the sole purpose of representing a risk purchasing group (RPG). As a result, non-resident SL producers who procured SL insurance on a risk located to some extent in Arizona would then contact an Arizona licensed SLB who would complete the affidavit (the 408 Report),¹ file the 408 Report with the Surplus Line Association of Arizona (SLA), and subsequently remit the tax due on the transaction. The resident SLB would usually be compensated by the non-resident SL producer for this service, in the form of shared commission or a fee. In some instances, the licensed Arizona SLB shared commission with a non-resident SL producer not even licensed as a property and casualty agent in Arizona. This practice of Arizona SLBs completing and filing the 408 Reports on behalf of non-resident SL producers who had procured (i.e., obtained) the SL insurance is commonly known as "courtesy filing."

¹ A.R.S. § 20-408(A) requires that within 60 days after procuring any SL insurance, the SLB shall execute and file with the Director a report in duplicate and under oath, setting forth the facts from which it may be determined whether the requirements of A.R.S. § 20-407 have been met. The report filed by the SLB with the Surplus Line Association of Arizona is commonly referred to as the "408 Report."

Although courtesy filings enable the payment of SL tax arising out of insurance on Arizona risks procured by unlicensed nonresidents, they are problematic for two reasons. Under Arizona law, only a licensed SLB may procure SL insurance on an Arizona risk. A.R.S. § 20-407(1). Therefore, it was illegal for an unlicensed, non-resident SL producer to procure the SL insurance and for the Arizona SLB to sign an affidavit that the Arizona SLB had procured the SL insurance, when in fact the SLB had not. Additionally, the SLB may have shared commission with the unlicensed nonresident. An Arizona licensee may only share commission with an insurance agent or broker licensed in Arizona. A.R.S. §§ 20-311 and 20-412.

As no law existed, with the exception of the RPG exception, that permitted nonresidents to obtain an Arizona, nonresident SLB license, the SLA received a substantial number of illegal courtesy filings. The intent of HB 2016 is to correct this problem by permitting a non-resident SLB's license to be issued to qualifying non-resident producers. As the courtesy filing issue was an ongoing source of confusion prior to the enactment of HB 2016, the Department has attached Exhibit 1 which contains questions and answers intended to clarify existing law and pertinent changes made by HB 2016.

Section 20-411.02, added by HB 2016, establishes the specific requirements for a non-resident individual or firm to be licensed as a SLB. If the applicant for non-resident licensure is a firm, the applicant is not permitted to have an office in this state. If the applicant for non-resident licensure is an individual, the individual may not be a resident of Arizona. Whether a firm or an individual, the applicant must comply with the following to be licensed as a non-resident SLB:

1. Be licensed as an Arizona non-resident property and casualty agent or broker;
2. Provide certification from the insurance regulatory official of the applicant's domiciliary state that the applicant is duly licensed as a SLB in that state and is in compliance with all applicable requirements of that license;
3. Be competent and trustworthy. A.R.S. §§ 20-411(B) and 20-411.02(B); and,
4. File with the Director a \$25,000 bond issued in favor of the state by an authorized surety. A.R.S. § 20-411(D).

The nonresident is not required to take a SLB examination in this state. When licensed as an Arizona non-resident SLB, the nonresident is required to submit the 408 Report to the SLA² and pay SL taxes in the same manner as required of a licensed Arizona resident SLB. The nonresident is not required to comply with Arizona continuing education requirements as long as the non-resident SLB has met the continuing education requirements in his or her resident state.

HB 2016 is clear that an Arizona non-resident SLB license **is not required for a nonresident who procures SL insurance in another state for a risk only partially located in Arizona** (i.e., a multi-state risk). The nonresident is merely required to pay the SL tax due this state pursuant to A.R.S. § 20-416(C). The Department shall prescribe the form of any reports or statements that are necessary for the nonresident to remit the tax. A.R.S. § 20-

² The SLA acts as the Department's agent for collection of the 408 Reports and tax information.

411.02(C). The tax forms to be used for remitting the tax on a multi-state risk where the Arizona portion is 50% or less are attached. The tax forms can also be found at the Department's web address: <http://www.state.az.us/id>. The nonresident is not required to complete or file the 408 Report with the SLA. No Arizona license of any kind is required of the nonresident when involved in this limited activity. Please note that although a risk may be a multi-state risk, if the Arizona location of the multi-state risk is the primary location, then this exception will not apply, and the nonresident must possess an Arizona non-resident SLB license. A "primary" Arizona location for which a non-resident SLB license would be required is a multi-state risk where the tax allocation to Arizona is greater than 50% pursuant to A.R.S. § 20-416 (C). In those cases where the Arizona portion of the risk is greater than 50%, the non-resident would pay the taxes in the same manner as if the risk were entirely located in Arizona.

A.R.S. § 20-411 states that a person shall not act as a SLB in Arizona unless the person possesses a current SLB license issued by the Director. HB 2016 added A.R.S. § 20-305 giving the Director authority to issue a cease and desist order to a person who illegally transacts SL insurance in this state.

Should you have any questions regarding this Circular, please feel free to contact Mike Dommin at the Department at (602) 912-8461 or Gerry Silver at the SLA at (602) 279-6344.

FREQUENTLY ASKED QUESTIONS AND ANSWERS

1. **Question:** *Is a licensed surplus lines broker (SLB), who obtains surplus lines (SL) coverage on behalf of a licensed Arizona property and casualty agent who cannot find coverage in the admitted market for the agent's applicant, required to file the 408 Report with the Surplus Line Association of Arizona (SLA)?*

Answer: Yes. Within 60 days after procuring the SL insurance, the SLB must file with the Director a report (the SLA acts as the Director's agent for the purpose of collecting these reports) by which it may be determined whether the requirements of A.R.S. § 20-407 have been met. A.R.S. § 20-408. This report is commonly referred to as the "408 Report."

2. **Question:** *May a licensed SLB share commission with a licensed Arizona resident or non-resident property and casualty agent who uses a SLB to acquire SL coverage in the SL market for the agent's applicant?*

Answer: Yes. A licensed SLB may accept or place SL insurance from any agent or broker licensed in Arizona for the kind of insurance involved (i.e., property and casualty insurance) and may compensate the agent or broker as long as the SLB contacts the SL insurer for coverage and files the 408 Report. The SLB has the right to receive from the insurer the customary commission. A.R.S. § 20-412.

3. **Question:** *May a licensed Arizona property and casualty agent directly place business with a SL insurer without going through a SLB?*

Answer: No. Any insurance coverage that cannot be obtained from authorized insurers may be obtained from a SL insurer subject to the condition that the insurance is procured through a licensed SLB. A.R.S. § 20-407(1). By coordinating with the SL insurer to be used to write the coverage, the SLB actually "procures" the SL insurance.

4. **Question:** *May a licensed Arizona SLB charge a licensed resident or non-resident property and casualty agent or broker a fee for placing the insurance with the SL insurer the SLB has contacted and for having completed and filed the 408 Report?*

Answer: Yes. As long as the SLB actually procures the SL insurance; and, the producer, on whose behalf the SLB is acting, is licensed in Arizona as a resident or non-resident agent or broker. If the fee is to be passed on to the SL insured, the SLB must pay the taxes required in A.R.S. § 20-416 on the fees and disclose to the insured or the insured's representative, who must agree in writing, the specific service for which the fee was charged. A.R.S. § 20-410(C).

- 5. Question:** *Is a licensed SLB, who obtains SL coverage on behalf of a licensed Arizona property and casualty agent having an applicant for whom the agent cannot find coverage in the admitted market, required to canvass the admitted market to determine whether admitted insurers will write the risk?*

Answer: No. A.R.S. § 20-407(2) requires that a diligent effort be made, but does not state who must make the diligent effort. The Department assumes that the licensed property and casualty agent could perform the due diligence and that the SLB may rely upon the agent's representations.

- 6. Question:** *May only licensed SLBs file the 408 Report with the SLA?*

Answer: Yes. A.R.S. § 20-408(A) states that it is the SLB who shall execute and file the Director's 408 Report. In no instance would the property and casualty agent be the one under the law to make the 408 Report filing.

- 7. Question:** *May a non-resident be licensed as a non-resident SLB in Arizona?*

Answer: Yes. HB 2016, effective July 18, 2000, permits nonresidents to be licensed as SLBs. A.R.S. § 20-411.02(A).

- 8. Question:** *To be licensed as an Arizona, nonresident SLB, must the nonresident first be licensed in Arizona as a non-resident property or casualty agent or broker?*

Answer: Yes. A.R.S. § 20-411.02(B) states that except as otherwise provided, a non-resident SLB is subject to the Arizona Revised Statutes, Title 20 (the "Insurance Code") as if licensed as a resident. A.R.S. § 20-411(B) and (F) require resident individuals or firms seeking a SLB license to first be licensed in Arizona as a property or casualty agent or broker. Therefore, nonresidents seeking a SLB license must also first be licensed in Arizona as a property or casualty agent or broker.

- 9. Question:** *Is a non-resident SLB required to file with the Director a bond, in favor of the State, with an authorized surety?*

Answer: Yes. The bond shall be in the aggregate amount of \$25,000. A.R.S. § 20-411(D).

- 10. Question:** *Is a non-resident required to take a SLB examination in this State?*

Answer: No.

- 11. Question:** *Is a non-resident SLB required to comply with continuing education requirements in this State?*

Answer: As long as the non-resident SLB has met the continuing education requirements in his or her resident state, the non-resident SLB does not have to meet continuing education requirements in Arizona.

12. Question: *May a non-resident, non-licensed SLB who is licensed as an Arizona non-resident property and casualty agent directly procure SL coverage in Arizona without going through a licensed Arizona SLB?*

Answer: No. A.R.S. § 20-407(1). The Arizona licensed non-resident property and casualty agent must go through the licensed SLB to access the SL insurer. The SLB must procure the SL insurance. The licensed agent and SLB may share the commission.

13. Question: *Is an Arizona agent, broker, or SLB's license required of a nonresident who obtains SL insurance in another state on a multi-state risk, part of which is located in Arizona?*

Answer: No. No Arizona license is required of the nonresident who obtains SL insurance in another state on a multi-state risk as long as Arizona is not the "primary" location of the risk (i.e., more than 50% of the tax allocation per A.R.S. § 20-416(C)). A.R.S. § 20-411.02(C).

14. Question: *Is a nonresident producer who procures SL insurance in another state on a multi-state risk, a part of which is located in Arizona, but which location is not the primary location, required to file the 408 Report with the SLA?*

Answer: No.

15. Question: *Is a nonresident who obtains SL insurance in another state on a multi-state risk, part of which is located in Arizona required to remit taxes to the Department on the portion of the risk located in Arizona?*

Answer: Yes. A.R.S. §§ 20-411.02(C) and 20-416. The tax amount due Arizona depends upon the proportion of the Arizona location to all other locations of the risk and will be transmitted on a form prescribed by the Department. The tax forms are available at the Department's web address: <http://www.state.az.us/id>.

16. Question: *At what point does the Arizona location of a "multi-state" risk become primary for the purpose of requiring the nonresident who obtains SL insurance in another state on a multi-state risk, part of which is located in Arizona, to be licensed as a non-resident SLB in Arizona?*

Answer: A multi-state risk for which no license is needed would be one where the tax allocation to Arizona under A.R.S. § 20-416 is 50% or less. Therefore, a primary Arizona location in Arizona for which a non-resident SLB license would be required would be where the tax allocation to Arizona under A.R.S. § 20-416 is more than 50%.

17. Question: *May a non-resident, non-licensed SLB who is NOT licensed as an Arizona non-resident agent procure SL insurance in Arizona by going through a licensed Arizona SLB?*

Answer: No. The nonresident needs to obtain a nonresident SLB's license in Arizona to obtain the SL insurance.

18. Question: *May an Arizona SLB sign the 408 Report and file it with the SLA for a nonresident producer, licensed as a non-resident Arizona agent or broker, if the SLB has contacted and obtained the SL insurance from the SL insurer to provide the coverage?*

Answer: Yes.

19. Question: *May an Arizona SLB receive a fee for filing the 408 Report or share commission with a non-resident Arizona agent or broker, if the SLB has contacted and obtained the SL insurance from the SL insurer to provide the coverage?*

Answer: Yes.

EXHIBIT 1



DEPARTMENT OF INSURANCE
STATE OF ARIZONA
Corporate and Financial Affairs Division
PREMIUM TAX UNIT
2910 NORTH 44TH STREET, SUITE 210
Phoenix, Arizona 85018-7256
Phone (602) 912-8429 Fax (602) 912-8421

NONRESIDENT SURPLUS LINES BROKER STATEMENT FILING AND TAX PAYMENT INSTRUCTIONS
A.R.S. §§ 20-411.02(C) and 20-416(C)

- A) **WHO MUST FILE:** An individual person, firm or corporation, licensed as a surplus lines broker license in another state that procures surplus lines insurance in another state, of which **50% or less of the exposure is allocable to properties or operations in Arizona**, must complete this statement and remit the tax due in accordance with A.R.S. §§ 20-411.02 (C) and 20-416 (C).
- B) **HOW TO COMPLETE FORM E-159MS:** The following information must be included within Form NONR-SLB to be in compliance with the reporting and tax remittance requirements:
- 1) **Complete the top portion** of Form E-159MS, including state of residence, state of residence license number, name as shown on resident license, mailing address, and telephone and fax numbers
 - 2) **Enter the Reporting Period** (see Paragraph C below) in the space provided in the title bar.
 - 3) **Fill in all spaces in the STATEMENT.** DO NOT round numbers. Enter "0" or "NONE" in all spaces where applicable. DO NOT file a BLANK Statement, as it will not fulfill the reporting requirement. Taxable **premiums include policy fees.**
 - 4) The **FIRE PORTION OF NET PREMIUMS must be provided** to enable the Department to allocate fire premium tax revenues to the Fire Fighters Relief and Pension Fund. Fire apportionment percentages are provided in column E, lines 2 through 6.
 - 4) The **TAX PAYMENT must be payable to the Arizona Department of Insurance** and must accompany Form E-159MS.
- C) **DUE DATES:** Pursuant to A.R.S. § 20-415, the due dates of the Statement and tax payment are:
September 1st for business transacted during the period of **January through June**
March 1st for business transacted during the period of **July through December**
BE SURE TO ENTER THE REPORTING PERIOD IN THE TITLE BAR, AS INSTRUCTED ABOVE.

It is the responsibility of each nonresident surplus lines broker to maintain separate and reconcilable records of surplus lines transactions reported on Form E-159MS.

Please call the Tax Unit at the telephone number above for assistance.



DEPARTMENT OF INSURANCE
STATE OF ARIZONA
 Corporate and Financial Affairs Division
PREMIUM TAX UNIT
 2910 NORTH 44TH STREET, SUITE 210
 Phoenix, Arizona 85018-7256
 Phone (602) 912-8429 Fax (602) 912-8421

NONRESIDENT SURPLUS LINES BROKER STATEMENT AND TAX PAYMENT
A.R.S. §§ 20-411.02(C) and 20-416(C)
 See Instruction Form E-159MS.I to complete this form

State of Residence _____ State of Residence License # _____
 Name on License _____
 Mailing Address _____
 Telephone # (____) _____ FAX # (____) _____

STATEMENT OF SURPLUS LINES PREMIUMS ALLOCABLE TO ARIZONA For Reporting Period of: _____

A Line of Business Description	B Aggregate Gross Premiums Charged	C Return Premiums Paid to Insureds	D Aggregate Net Premiums	E Fire %	F Fire Portion (Column D x E)
1. Disability (includes accident)	\$ _____ [DA Gross]	(-) \$ _____	= \$ _____ [DA Tax]		XXXXXXXXXX
2. Property - Fire	\$ _____ [PF Gross]	(-) \$ _____	= \$ _____ [PF Tax]	85%	
3. Property - All Other	\$ _____ [PO Gross]	(-) \$ _____	= \$ _____ [PO Tax]	25%	
4. Marine & Inland Transportation	\$ _____ [MT Gross]	(-) \$ _____	= \$ _____ [MT Tax]	50%	
5. Vehicle - Aircraft	\$ _____ [VA Gross]	(-) \$ _____	= \$ _____ [VA Tax]	5%	
6. Vehicle - Land	\$ _____ [VL Gross]	(-) \$ _____	= \$ _____ [VL Tax]	10%	
7. Casualty	\$ _____ [C Gross]	(-) \$ _____	= \$ _____ [C Tax]		XXXXXXXXXX
8. Surety	\$ _____ [S Gross]	(-) \$ _____	= \$ _____ [S Tax]		XXXXXXXXXX
9. Purchasing Groups (Attach List)	\$ _____ [PG Gross]	(-) \$ _____	= \$ _____ [PG Tax]		XXXXXXXXXX
10. Other - Describe	\$ _____ [OT Gross]	(-) \$ _____	= \$ _____ [OT Tax]		XXXXXXXXXX
11. TOTAL OF ALL COLUMNS	\$ _____ [SL Gross]	(-) \$ _____	= \$ _____ [SL Taxable]	\$	[SLF Gross/Tax]
12. Surplus Lines Tax Rate			3%		Make Check Payable to:
13. SURPLUS LINES PREMIUM TAX DUE (Column D, Line 11 x 0.03) Pay this amount:			= \$ _____		"Arizona Department of Insurance" Send to Address Above

This report has been prepared in accordance with the provisions of A.R.S. §§ 20-411.02(C) and 20-416(C) for surplus lines insurance procured in another state by the nonresident broker named above, of which 50% or less of the exposure is allocable to properties or operations in Arizona.

Signature of Broker Named Above _____ Date Prepared _____