Much Ado about Dodd-Frank

by Thomas P. Stokes

Retirement may beckon for Massachusetts U.S. Representative Barney Frank, but speculation about the bill he cosponsored, the Nonadmitted and Reinsurance Reform Act ("NRRA") of 2010[1], promises to become part of his legacy. The bill was passed as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

Considering the bill's wording, its applicability is open to interpretation and the ultimate execution by the states (and probably the courts), it is easy to predict much more debate to come.

Concerns Shared by Captives and Managers

NRRA does not purport to grant the states new authority to impose premium taxes, nor does discussion leading up to the bill's passage mention captive insurance specifically. Regardless, captive owners and service providers have questions:

- Is the bill intended to go beyond a strict focus on surplus lines insurance transactions? It is clear from reading the bill that the independent procurement of insurance by a qualified risk manager is included. The question is whether and how well captive insurance fits within the definition of "independent procurement."

- Without overturning US Supreme Court rulings, can NRRA empower states to impose premium taxes on insurance transactions taking place outside of their jurisdiction?

- Are states willing and able to enter into an equitable compact to distribute the taxes collected timely and accurately?

Others well versed in this area have conducted their own in-depth analyses on the applicability of NRRA to captive insurance transactions. For various reasons, including provisions of the U.S. Constitution, the McCarran-Ferguson Act and U.S. and state Supreme Court cases (like Todd Shipyards and Dow Chemical), as well as the fact that most states do not recognize captive insurance transactions in the same manner as commercial ones, many observers believe the NRRA does not encompass captive insurance transactions. Logic, however, does not always prevail.

At this juncture, the outcome of NRRA is anything but certain because:

- If one is to buy into the rhetoric that the bill does not give the states any new authority to impose insurance taxes and that McCarran-Ferguson is still valid, the federal government should not have the authority to compel the states to act. The flip side is that the courts may interpret NRRA as superseding McCarran-Ferguson, paving the way for new opportunities to access captive transactions.

[1] The Nonadmitted and Reinsurance Reform Act was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) on July 21 of 2010.

- Loose and ambiguous language in preparing statutes can be used to allow leeway in future interpretations of the law by regulators and the courts. By incorporating vagaries into the legislation, either through direct intent or the unintended result of uninformed expedience, those imposing the legislation can interpret the wording to their best advantage.

- Critical budget shortfalls provide the incentive for regulators to be more aggressive in applying the legislation to specific transactions in what might otherwise appear to be an anti-business position. In states where there are huge budget shortfalls, we could see aggressive interpretations incorporating taxes on captive premiums to maximize revenue.

There will be much more ado over the NRRA before the dust settles, thus, taking precipitous action of any kind at this point is premature. Seemingly simple concepts like the definition of “home state” may prove to be thorny. Paraphrased, “home state” is defined within the NRRA as the state in which an insured maintains its principal place of business, or, if 100 percent of the insured risk is located outside of the state of the principal place of business, the state to which the greatest percentage of the insured’s taxable premium ***for that contract*** is allocated.

Does this mean that for companies whose principal place of business is in one state, multiple states can claim jurisdiction on a contract by contract basis? Also, it will take some time to coordinate the efforts of all of the states to develop a unified system for collection and distribution of taxes on transactions deemed taxable in their states.

With evolving interpretations of constitutional protections and increasing challenges to McCarran-Ferguson[2] combined with severe budget pressures, a possibility exists that NRRA could be interpreted to encompass captive insurance transactions. This may take some time, but in the interim, captive owners should remain vigilant and, when called upon, make their voices heard through all possible channels. Count on the captive management professionals of The Towner Management Group to keep you informed as events change.

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[2] Which is a perennial possibility—as recently as 2009 there were challenges to McCarran-Ferguson, calling for some or all of its repeal. On October 14, 2009, Senator Charles Schumer (D) NY called for the repeal of the McCarran-Ferguson provisions pertaining to health insurance companies.