

HOUSE OF REPRESENTATIVES FINAL BILL ANALYSIS

BILL #:	CS/CS/HB 1163	FINAL HOUSE FLOOR ACTION:	
SPONSOR(S):	Regulatory Affairs Committee; Insurance & Banking Subcommittee; Hager	117 Y's	0 N's
COMPANION BILLS:	CS/CS/SB 1422	GOVERNOR'S ACTION:	Approved

SUMMARY ANALYSIS

CS/CS/HB 1163 passed the House on March 8, 2016, as CS/CS/SB 1422.

The Office of Insurance Regulation (OIR) is responsible for solvency oversight over insurers and other risk-bearing entities, in order to protect policyholders against the risk that insurers will not be able to meet their financial responsibilities. Additionally, the OIR is a member of the National Association of Insurance Commissioners (NAIC), an organization of state insurance regulators that establish standards and best practices, conduct peer reviews, and coordinate their regulatory oversight. As a member of the NAIC, the OIR is required to participate in the organization's accreditation program, which is a certification that legal, regulatory, and organizational oversight standards and practices are being fulfilled by a state insurance department.

The OIR has identified two NAIC model acts as critical solvency regulation tools - the Own Risk Solvency Assessment (ORSA) and the Corporate Governance Annual Disclosure (CGAD):

- ORSA requires insurers to analyze all reasonable foreseeable and relevant material risks potentially affecting their ability to meet policyholder obligations. This will provide the OIR with an effective early warning mechanism and provides a group-level perspective on risk and capital. Effective January 1, 2018, ORSA is an NAIC accreditation standard.
- CGAD will provide the OIR with a detailed narrative describing governance practices to promote market stability and to deter unethical behavior.

The bill creates s. 628.8015, F.S., to implement the ORSA and CGAD model acts, and:

- Provides criteria for the OIR to exempt certain insurers and insurance groups and to provide waivers of ORSA requirements, and provides a delayed compliance date for CGAD filings, with certain exceptions;
- Provides that ORSA and CGAD filings and related documents are privileged and not subject to subpoena or discovery directly from the OIR, and are not admissible in evidence in any private civil action;
- Authorizes the OIR to retain third-party consultants to assist in its administration of the bill and specifies requirements for such third-party consultants;
- Authorizes the Financial Services Commission to adopt rules to implement the ORSA and CGAD requirements;
- Authorizes the OIR to impose sanctions, for failure to submit ORSA summary reports or CGADs; and
- Provides for the contingent repeal of these changes, if the linked public records bill is not reenacted.

The bill has a positive, yet indeterminate fiscal impact on state revenues. In addition, the bill has an insignificant negative fiscal impact to state expenditures of the OIR related to enhancements to the technology systems utilized by the OIR. The bill has no fiscal impact on local government. The bill has an indeterminate fiscal impact on the private sector, in that it requires new regulatory reporting duties from insurers and will subject them to third-party consultant regulatory costs and other sanctions for violations. However, these insurer regulatory reports may reduce regulatory redundancies with other states and may enhance the OIR's solvency oversight.

The bill was approved by the Governor on April 8, 2016, ch. 2016-206, L.O.F., and will become effective on October 1, 2016.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h1163z1.IBS

DATE: April 12, 2016

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Current Situation

Insurer Solvency Regulation & NAIC Accreditation

The regulatory oversight of insurance companies is generally reserved to the states. In Florida, the Office of Insurance Regulation (OIR) is responsible for all activities concerning insurers and other risk bearing entities, including licensing, rates, policy forms, market conduct, claims, issuance of certificates of authority, solvency, viatical settlements, premium financing, and administrative supervision, as provided under the insurance code or ch. 636, F.S.¹ Solvency regulation is designed to protect policyholders against the risk that insurers will not be able to meet their financial responsibilities, namely, the payment of claims. Solvency regulations include the initial and maintenance requirements for an insurer's authority to transact insurance in this state,² monitoring the financial condition of insurers through examinations, audits, and procedures for the administrative supervision, rehabilitation, or liquidation of an insurance company if found to be in an unsound financial condition or insolvent.³

The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance departments that regulate the conduct and solvency of insurers in their respective states or territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer reviews, and coordinate their regulatory oversight.⁴ As a member of the NAIC, the OIR is required to participate in the organization's Financial Regulation Standards and Accreditation Program.⁵

NAIC accreditation is a certification that legal, regulatory, and organizational oversight standards and practices are being fulfilled by a state insurance department to promote sound insurer financial solvency regulation. The accreditation program is also designed to allow for interstate cooperation and reduces regulatory redundancies. For example, the OIR's examinations may be recognized by other member states, thereby avoiding the need to have a Florida domestic insurer examined by multiple states. All fifty states, the District of Columbia, and Puerto Rico are accredited by the NAIC. Once accredited, a state is subject to a full accreditation review every five years, as well as interim reviews. One major component of NAIC accreditation standards is the adequacy of solvency laws and regulations in each accredited state to protect consumers and guaranty funds, through the adoption of model laws.⁶ The NAIC also periodically reviews these model solvency standards, and revises accreditation requirements to adapt to evolving industry practices.

In the wake of the 2008 financial crisis, U.S. insurance regulators began to modify their supervisory framework in order to be able to assess the holding company's financial system (as a whole) and its

¹ s. 20.121(3)(a)1., F.S. The OIR's commissioner is the agency head for purposes of final agency action, and its rulemaking body is the Financial Services Commission (the Governor and the Cabinet).

² Pt. III, ch. 624, F.S.

³ *Administrative supervision* allows the Department of Financial Services (DFS) to supervise the management of a consenting troubled insurance company in an attempt to cure the company's troubles, rather than close it down. In *rehabilitation*, the DFS is authorized to act as the receiver to conduct all business of the insurer in an attempt to place the insurance company back in sound financial condition. In *liquidation*, the DFS is authorized as the receiver to gather an insolvent insurance company's assets, convert them to cash, distribute them to various claimants, and close the company. Ch. 631, F.S., governs these receivership processes for insurance companies, as well as the five guaranty funds to ensure policyholders of liquidated insurers are protected with respect to insurance premiums paid and the settlement of outstanding claims, up to limits provided by law.

⁴ NAIC, *About the NAIC*, http://www.naic.org/index_about.htm (last visited Jan. 28, 2016).

⁵ NAIC, *Financial Regulation Standards and Accreditation Committee*, at http://www.naic.org/committees_f.htm (last visited Jan. 28, 2016).

⁶ All NAIC Model Laws, Regulations and Guidelines are available at: http://www.naic.org/store_model_laws.htm (last visited Jan. 28, 2016).

impact on an insurer within the holding company system. The AIG Financial Products unit based in London, a non-insurance component of the AIG holding company system, experienced significant losses from risky investments. The contagion effects experienced by U.S. insurers in the AIG holding company system's near collapse prompted U.S. insurance regulators to reevaluate their group supervisory framework and pay closer attention to the risks created by activities going on outside of those entities as well as the reputational and contagion issues that could exist.⁷

In 2008, the NAIC launched the Solvency Modernization Initiative (SMI) as a critical self-examination to update the U.S. insurance solvency framework. SMI focused on key issues such as capital requirements (including risk-based capital), governance and risk management, group supervision, statutory accounting and financial reporting, and reinsurance. In 2014, the Legislature enacted updates to the Insurance Code to include these new NAIC model elements necessary for the OIR to maintain its accreditation, including the Insurance Holding Company System Model, Risk-Based Capital for Insurers and Health Organization, the Property & Casualty Actuarial Opinion Model Law, and the Standard Valuation Law.⁸

The OIR has identified two model acts that the NAIC adopted as part of its Solvency Modernization Initiative and its Corporate Governance Working Group: the Own Risk and Solvency Assessment Act and the Corporate Governance Disclosure Model Act.

Own Risk and Solvency Assessment (ORSA)

In 2011, as part of the NAIC's SMI, the NAIC adopted a new insurance regulatory tool: the U.S. Own Risk and Solvency Assessment (ORSA), which will require insurance companies to issue their own assessment of their current and future risk through an internal risk self-assessment process, which will allow regulators to form an enhanced view of an insurer's ability to withstand financial stress, particularly on a holding company's level.⁹ In essence, an ORSA is an internal process undertaken by an insurer or insurance group to assess the adequacy of its risk management and current and prospective solvency positions under normal and severe stress scenarios. An ORSA will require insurers to analyze all reasonably foreseeable and relevant material risks (i.e., underwriting, credit, market, operational, liquidity risks, etc.) that could have an impact on an insurer's ability to meet its policyholder obligations.

The "O" in ORSA represents the insurer's "own" assessment of their current and future risks. Insurers and insurance groups will be required to articulate their own judgment about risk management and the adequacy of their capital position. This is meant to encourage management to anticipate potential capital needs and to take action proactively, and serves as an early warning mechanism for insurance regulators. ORSA is not a one-off exercise - it is a continuous evolving process and should be a component of an insurer's enterprise risk-management framework. Moreover, there is no mechanical way of conducting an ORSA; how to conduct the ORSA is left to each insurer to decide, and actual results and contents of an ORSA report will vary from company to company. The output will be a set of documents that demonstrate the results of management's self-assessment.

Effective January 1, 2018, ORSA is an NAIC accreditation standard for state insurance regulators. As of November 2015, thirty-four states have adopted ORSA.¹⁰

Corporate Governance Annual Disclosure (CGAD)

⁷ NAIC, *Own Risk and Solvency Assessment (ORSA)*, http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm (last visited Jan. 29, 2016).

⁸ Ch. 2014-101, Laws of Fla.

⁹ NAIC, *Own Risk and Solvency Assessment (ORSA)*, at http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm (last visited Jan. 29, 2016).

¹⁰ OIR, *Q&A on ORSA and CGAD* (Nov. 15, 2015), on file with the Insurance & Banking Subcommittee staff.

Currently, during full-scope financial examinations, the OIR obtains some information on insurer governance structures, processes and practices. However, these examinations are typically limited to domestic insurers and occur only once every five years.¹¹ In the period between these examinations, the OIR's access to insurer governance practices is more limited. This can mask changes and activities having a substantial bearing on the financial condition of the insurer.¹²

In 2012, the NAIC formed the Corporate Governance Working Group to outline high-level corporate governance principles for use in U.S. insurance regulation and to develop regulatory guidance, including detailed best practices, for the corporate governance of insurers. In 2014, the NAIC adopted the Corporate Governance Annual Disclosure Model Act (CGAD) and supporting Model Regulations.¹³

In the CGAD, insurers must document highly confidential information about their corporate governance framework, including the structure and policies of their boards of directors and key committees, the frequency of their meetings, and procedure for the oversight of critical risk areas and appointment practices, among other things. Insurers must also disclose the policies and practices used by their board of directors for directing senior management on critical areas, including a description of codes of business conduct and ethics, and processes for performance evaluation, compensation practices, corrective action, succession planning and suitability standards. The CGAD will provide regulators with a detailed narrative describing governance practices to promote market stability and to deter unethical behavior.

Upon state adoption of the NAIC models and as early as June 1, 2016, each U.S. insurer or the insurance group in which the insurer is a member, must submit a CGAD to its lead state or domestic regulator on an annual basis.¹⁴ According to the NAIC, five jurisdictions have adopted the CGAD in a substantially similar form.¹⁵

Effect of the Bill

The bill creates s. 628.8015, F.S., to require insurers or insurance groups (as applicable), to file an ORSA and CGAD with their domestic regulator or lead state.

Definitions

In addition to defining “corporate governance annual disclosure,” “ORSA,” “ORSA guidance manual,” and “ORSA summary report,” the bill defines the following:

- “Insurer” is defined as the same as in s. 624.03, F.S.,¹⁶ but excludes state and federal agencies, authorities, instrumentalities, possessions, territories, or political subdivisions of a state;
- “Insurance group” is defined to mean insurers and affiliates included within an insurance holding company system; and
- “Senior management” is defined to mean any corporate officer responsible for reporting information to the board of directors at regular intervals or providing information to shareholders or regulators. This includes, but is not limited to, a number of executives such as chief executive officer, chief financial officer, and chief risk officer.

ORSA

¹¹ s. 624.316(2)(a), F.S.

¹² Office of Insurance Regulation, Agency Analysis of 2016 House Bill 1163, p. 3 (Jan. 22, 2016).

¹³ The CGAD Model Act and supporting Model Regulations are currently exposed for public comment until December 31, 2016, and may be considered for adoption as a NAIC accreditation standard in 2017, effective January 2019. *See supra* note 9.

¹⁴ NAIC, *Corporate Governance*, at http://www.naic.org/cipr_topics/topic_corporate_governance.htm (last visited Jan. 29, 2016).

¹⁵ These five states are California, Indiana, Iowa, Louisiana, and Vermont. Office of Insurance Regulation, Agency Analysis of 2016 House Bill 1163, p. 3 (Jan. 22, 2016).

¹⁶ Section 624.03, F.S., defines “insurer” to mean every person engaged as an indemnitor, surety, or contractor in the business of entering into contracts of insurance or of annuity.

The bill incorporates the three major components of the ORSA, to require insurers or insurance groups to:

- Maintain a *risk management framework* for identifying, assessing, monitoring, managing, and reporting on its material, relevant risks;
 - This requirement may be satisfied by being a member of an insurance group with a risk management framework applicable to the insurer's operations.
- Conduct an ORSA at least annually (and whenever there have been significant changes to the risk profile of the insurer or the insurance group), consistent with and comparable to the process in the ORSA Guidance Manual;¹⁷ and
- File an ORSA summary report, based on the ORSA Guidance Manual with their domestic regulator or lead state (for an insurance group), beginning in 2017, which must:
 - Be submitted once every calendar year;
 - Include notification to the OIR of its proposed annual submission date by December 1, 2016; initial ORSA summary report must be submitted by December 31, 2017;
 - Include a brief description of material changes and updates from the prior year's report;
 - Be signed by the chief risk officer or chief executive officer responsible for overseeing the enterprise risk management process; provide copy to board of directors or appropriate board committee; and
 - Be prepared in accordance with the ORSA guidance manual; the insurer must maintain and make available for OIR examination documentation and supporting information.

ORSA Exemption & Waiver

The bill exempts an insurer from the ORSA requirement if:

- Its annual direct written and unaffiliated assumed premium is less than \$500 million (excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program); or
- It is a member of an insurance group with an annual direct written and unaffiliated assumed premium of \$1 billion or less (excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program).¹⁸

The bill also sets forth reporting obligations, depending on the exempt status of the insurer and its insurance group. Additionally, the OIR may still require an exempt insurer to maintain a risk management framework, conduct and file an ORSA summary report based on certain circumstances such as: an exempt insurer's risk-based capital that triggers a company action level event,¹⁹ an exempt insurer exhibits qualities of an insurer in hazardous financial condition, or it is in the best interest of the state.

In addition, the bill allows OIR to grant a waiver to an otherwise non-exempt insurer based on unique circumstances, and specifies criteria for the OIR to consider.

CGAD

¹⁷ The bill defines "ORSA guidance manual" as the ORSA manual developed and adopted by the NAIC. See NAIC, *ORSA Guidance Manual* (Jul. 2014), at http://www.naic.org/store/free/ORSA_manual.pdf.

¹⁸ According to the OIR, two property and casualty insurer groups and five life and health insurer groups meet the ORSA threshold and have Florida as the lead state. OIR, *Q&A on ORSA and CGAD* (Nov. 15, 2015), on file with the Insurance & Banking Subcommittee staff. This information is based on 2014 premium data.

¹⁹ Section 624.81(11), F.S., authorizes the OIR to place an insurer under administrative supervision and order corrective action if the insurer is in unsound condition, exceeds its powers granted under its certificate of authority, or its practices are hazardous to the public. Commission rule defines "hazardous financial condition" in accordance with NAIC model regulation. Rule 69O-141.002, F.A.C.

The bill requires insurers or insurer members of insurance groups (of which the OIR is the lead state regulator) to submit a CGAD the 1st of every June, with an initial CGAD to be submitted by December 31, 2018.²⁰ However, the bill provides that the OIR may request the CGAD prior to December 31, 2018, under certain circumstances. The CGAD must be signed by the CEO or corporate secretary, and must describe the insurer or insurance group's governance framework and structure, relevant policies and practices, and processes for overseeing critical risk areas affecting business activities.

The bill allows insurers and insurance groups to provide corporate governance information at the ultimate controlling parent level, the intermediate holding company level, or at the individual legal entity level. Additionally, insurers and insurance groups may make their CGAD at levels at which the insurer or insurance group 1) determines risk appetite, 2) oversees or exercises coordinated supervision of earnings, capital, liquidity, operations, and reputation of the insurer, or 3) at which legal liability would be placed for failure of general corporate governance duties. The insurer or insurance group must indicate their level of reporting and explain any subsequent changes, and may meet these requirements by referring other relevant and existing documents, such as the ORSA summary report, Holding Company B or F filings, and Securities and Exchange Commission proxy statements. The lead state may request additional information and must review the CGAD in accordance with the NAIC Financial Handbook. Insurers and insurance groups must report subsequent changes to the CGAD.

Privilege & Confidentiality of ORSA & CGAD

The bill provides that the ORSA and CGAD filings and related documents that are submitted pursuant to this newly created s. 628.8015, F.S., are privileged and not subject to subpoena or discovery directed to the OIR, and any such filings and related documents, if obtained from the OIR, are not admissible in evidence in any private civil action.²¹ The bill prohibits the OIR, or any person acting under the OIR's authority (such as third-party consultants), from testifying as to such filings or related documents in a private civil action. However, the OIR or the Department of Financial Services may use these filings and related documents in any regulatory or legal action it brings against an insurer as part of their official duties. The bill also provides that any applicable claims of privilege as to these filings and related documents are not waived simply because a disclosure to the OIR under this section or under any other provision of the Insurance Code.

Substantially similar privilege language was enacted in 2014 for other insurer regulatory filings:

- Section 628.801(4), F.S., regarding insurance holding company registration statements and annual enterprise risk reports; and
- Section 625.1214, F.S., relating to annual actuarial opinions of reserves and supporting memoranda required of life insurers.

Third-Party Consultants

The bill authorizes the OIR to retain third-party consultants at the expense of the insurer or the insurance group for the purpose of assisting the OIR with ORSA and CGAD responsibilities. The bill requires these third-party consultants and the NAIC to adhere to confidentiality and conflict of interest standards through a written agreement with the OIR, which includes an agreement not to store the information shared pursuant to the bill in a permanent database after the underlying analysis is completed, provide prompt notice to the OIR and to the insurer or insurance group regarding any subpoena or other request for the filings, and intervention by an insurer in any judicial or administrative

²⁰ The delayed compliance date for CGAD filings is due to the pending comment period for the CGAD Model Act as an accreditation component. *See supra*, notes 9 and 13.

²¹ In 2014, substantially similar privilege language was enacted for other insurer regulatory filings, regarding insurance holding company registration statements, enterprise risk reports, and annual actuarial opinions of reserve and supporting memoranda required of life insurers. Ch. 2014-101, ss. 8 and 11, Laws of Fla; *see* ss. 628.801(4) and 625.1214, F.S.

action in which the NAIC or a third-party consultant may be required to disclose confidential information about the insurer.

In other areas of the Insurance Code, the OIR has authority to contract with independent external auditors or examiners under the following provisions:

- s. 624.316(2)(e), F.S., OIR general examination authority;
- s. 624.3161(3), F.S., OIR market conduct examination authority;
- s. 624.44(1)(c), F.S., multiple-employer welfare arrangements; and
- s. 641.27(2), F.S., for health maintenance organization examinations.

Rulemaking

The bill authorizes the Financial Services Commission to adopt rules to administer the bill.

Sanctions

Currently, s. 628.803, F.S., authorizes the OIR to impose sanctions, including fines, on insurers and certain affiliated individuals of insurers for certain violations. The 2014 insurer solvency legislation authorizes the OIR to place an insurer under an order of supervision and to disapprove dividends or distributions, if the OIR finds that the insurer violated s. 628.461, F.S., (acquisition of controlling stock requirements) or s. 628.801, F.S., (insurance holding company registration statement and enterprise risk reporting requirements).²²

Section 2 of the bill amends s. 628.803, F.S., to provide that the OIR may impose these fines for failure to submit an ORSA summary report or CGAD, or may issue an order of supervision and disapprove dividends or distributions if an insurance company violates the newly created s. 628.8015, F.S., created in the bill.

Contingent Repeal

Section 3 of the bill provides that the changes made by the bill are repealed on October 2, 2021, unless the amendments to s. 624.4212, F.S., made by the linked public records bill, SB 1416 or similar legislation, are reviewed and saved from repeal through reenactment by the Legislature.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The bill has a positive, yet indeterminate fiscal impact on state revenues. The bill applies existing sanctions from s. 628.803, F.S., relating to insurers' failure to file a holding company registration statement to include failure to file an ORSA or a CGAD as required in the bill. The sanctions included in s. 628.803, F.S., provide that insurers in violation of the statute are subject to a penalty of \$100 for each day's delay, not to exceed a total of \$10,000.²³

2. Expenditures:

²² s. 628.803(4), F.S.; s. 12, ch. 2014-101, Laws of Fla.

²³ s. 628.803(1), F.S.

The bill has an insignificant negative fiscal impact to state expenditures of the OIR related to enhancements to the technology systems utilized by the OIR. However, the OIR indicates that any expenditure increase to accommodate the collection of additional information through their current technology systems can be handled within existing resources.²⁴

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The fiscal impact to the private sector is indeterminate. The bill exposes insurers and insurance groups to additional fines and sanctions and third-party consultant costs incurred by the OIR. However, it may have a positive impact by enhancing the OIR's solvency oversight and thus ultimately benefit policyholders.

According to the OIR, insurers should realize indeterminate cost savings through regulatory efficiencies resulting from adoption of the ORSA Model Act and elimination of regulatory redundancies (i.e., having to make separate filings in each state). Complying with the CGAD is estimated to have only a minimal fiscal impact on insurers and insurance groups, since they currently summarize and describe their corporate governance practices for a number of stakeholders on a regular basis. In addition, the CGAD permits insurers and insurance groups to reference existing documents and filings and simplifies the reporting process for filing changes from the prior year.²⁵

D. FISCAL COMMENTS:

None.

²⁴ Email correspondence with the OIR (Jan. 20, 2016).

²⁵ *Id.*