

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/HB 387 Nonadmitted Insurance Markets

**SPONSOR(S):** Insurance & Banking Subcommittee; Burton

**TIED BILLS:** IDEN./SIM. BILLS: SB 538

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	13 Y, 0 N, As CS	Lloyd	Luczynski
2) Ways & Means Committee			
3) Commerce Committee			

### SUMMARY ANALYSIS

Surplus lines insurance refers to insurance for which the admitted market is unable or unwilling to provide coverage. There are three basic categories of surplus lines risks: specialty risks (unusual risks seen as undesirable to insurers); niche risks (ones without an approved Florida policy form or rate); and capacity risks (where an insured needs higher coverage than otherwise available). Surplus lines insurers are not “authorized” insurers and do not obtain a certificate of authority from the Office of Insurance Regulation (OIR); rather, they are “unauthorized” insurers that may transact surplus lines insurance, if they are made eligible by OIR.

The Florida Surplus Lines Service Office (FSLSO) is a self-regulating, nonprofit association of approved unauthorized insurers. All licensed surplus lines agents are deemed to be members of the FSLSO. In order to place coverage with a surplus lines carrier, with certain exceptions the agent must make a “diligent effort” to place the policy with a Florida-authorized insurer, i.e., one with a certificate of authority from OIR. Surplus lines agents are required to report and file with the FSLSO specified information on each surplus lines insurance policy within specified timelines and with required content. One such requirement is the quarterly filing of an affidavit attesting to the diligent effort required when placing a policy with a surplus lines insurer, known as “exporting” a policy. An exported policy is subject to a 5 percent premium tax, except for risks primarily located in another state, which are taxed at the other state’s applicable tax rate. The agent collects the tax at the applicable rate and remits it to FSLSO for payment to the state of Florida. To cover these reporting requirements, a surplus lines agent may charge a reasonable per-policy fee, not to exceed \$35.

The National Flood Insurance Program (NFIP) is the largest insurer of Florida flood risks nationally and in Florida. The NFIP has 1.8 million policies in Florida as of September 30, 2018. The surplus lines market and admitted market are far below the NFIP coverage level with 47,130 policies and 50,438 policies, respectively. In 2014 and subsequently, the Legislature has acted to encourage development of the Florida admitted flood market. To do so, regulatory requirements have been lowered for forms and rates. While the admitted market develops, surplus lines agents may export policies without obtaining coverage rejections from admitted insurers. This exemption to the diligent effort requirement expires on July 1, 2019, unless the Insurance Commissioner declares that there is an adequate admitted flood insurance market at an earlier date.

The bill:

- Removes the \$35 cap on the reasonable per-policy fee allowed to the surplus lines agent and requires that the fee be separately itemized to the insured before purchase and enumerated on the policy;
- Eliminates the required affidavit (this information is otherwise available in electronic data filings);
- Extends the exemption from diligent effort requirements for exporting of flood insurance risks (but the Insurance Commissioner may end this exemption at any time upon declaring an adequate admitted market for flood coverage exists in the state).

The bill has no impact on state or local government revenues or expenditures. It has positive and negative impacts on the private sector.

The bill is effective July 1, 2019.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### **Surplus Lines Overview**

Surplus lines insurance refers to a category of insurance for which the admitted market is unable or unwilling to provide coverage.<sup>1</sup> There are three basic categories of surplus lines risks:

- Specialty risks that have unusual underwriting characteristics or underwriting characteristics that admitted insurers view as undesirable;
- Niche risks for which admitted carriers do not have a filed policy form or rate; and
- Capacity risks that are risks where an insured needs higher coverage limits than those that are available in the admitted market.

Surplus lines insurers are not “authorized” insurers as defined in the Florida Insurance Code,<sup>2</sup> which means they do not obtain a certificate of authority from the Office of Insurance Regulation (OIR) to transact insurance in Florida.<sup>3</sup> Rather, surplus lines insurers are “unauthorized” insurers<sup>4</sup> that may transact surplus lines insurance, if they are made eligible by OIR.

The Florida Surplus Lines Service Office (FSLSO) is a self-regulating, nonprofit association of approved unauthorized insurers established by the Legislature in 1997. The FSLSO was created to protect consumers seeking surplus line insurance in the state, monitor marketplace compliance, and protect state revenues.<sup>5</sup> All licensed surplus lines agents are deemed to be members of the FSLSO. The FSLSO operates under the supervision of a nine-member board of governors, which has oversight responsibilities for the Florida surplus lines market.

“To export” a policy<sup>6</sup> means to place it with an unauthorized insurer under the Surplus Lines Law.<sup>7</sup> Unless an exception applies, before an insurance agent can place insurance in the surplus lines market, the insurance agent must make a diligent effort to procure the desired coverage from admitted insurers.<sup>8</sup> “Diligent effort” means, subject to certain exceptions,<sup>9</sup> seeking coverage from and being rejected by at least three authorized insurers in the admitted market.<sup>10</sup> The law further specifies that:<sup>11</sup>

- The premium rate for policies written by a surplus lines insurer cannot be less than the premium rate used by a majority of authorized insurers for the same coverage on similar risks;
- The policy exported cannot provide coverage or rates that are more favorable than those that are used by the majority of authorized insurers actually writing similar coverages on similar risks;
- The deductibles must be the same as those used by one or more authorized insurers, unless the coverage is for fire or windstorm; and

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<sup>1</sup> The admitted market is comprised of insurance companies licensed to transact insurance in Florida. The administration of surplus lines insurance business is managed by the Florida Surplus Lines Service Office. S. 626.921, F.S.

<sup>2</sup> The Florida Insurance Code is chapters 624-632, 634, 635, 636, 641, 642, 648, and 651, F.S. S. 624.01, F.S.

<sup>3</sup> S. 624.09(1), F.S.

<sup>4</sup> S. 624.09(2), F.S.

<sup>5</sup> See S. 626.921, F.S. and FLORIDA SURPLUS LINES SERVICE OFFICE, *About*, <https://www.fslso.com/about> (last visited Feb. 14, 2019).

<sup>6</sup> S. 626.914(3), F.S.

<sup>7</sup> Sections 626.913 – 626.937 constitute and may be referred to as the “Surplus Lines Law.” S. 626.913(1), F.S.

<sup>8</sup> S. 626.916(1)(a), F.S.

<sup>9</sup> Exceptions include commercial lines risk, such as “excess or umbrella, surety and fidelity, boiler and machinery and leakage and fire extinguishing equipment,” and so on, as specified in s. 627.062(3)(d)1., F.S. S. 626.916(3)(b), F.S.

<sup>10</sup> If the cost to replace a residential dwelling is \$1,000,000 or more, then only one coverage rejection is needed prior to export. S. 626.914(4), F.S. When exporting a flood insurance policy, diligent effort requirements do not apply until July 1, 2019, or the Insurance Commissioner declares an adequate flood insurance market among admitted insurers, whichever occurs first. S. 627.715(4), F.S.

<sup>11</sup> S. 626.916(1), F.S.

- For personal residential property risks,<sup>12</sup> the policyholder must be advised in writing that coverage may be available and less expensive from Citizens Property Insurance Corporation (Citizens).

## **Surplus Lines Agents**

Surplus lines agents are authorized to handle the placement of insurance coverages with surplus lines insurers, and to place coverages with authorized insurers with whom the agent is not licensed.<sup>13</sup> Licensed resident general lines agents who meet the statutory criteria for licensure are eligible for licensure as a surplus lines agent.<sup>14</sup> In order to place coverage with a surplus lines carrier, the agent must make a “diligent effort” to place the policy with a Florida-authorized insurer, i.e., one with a certificate of authority from OIR.

Surplus lines agents are required to report and file with the FLSO specified information on each surplus lines insurance policy within 30 days of the effective date of the transaction, must transmit service fees to the FLSO each month, and must transmit assessment and tax payments to the FLSO quarterly.<sup>15</sup> When requested by the Department of Financial Services or the FLSO, surplus lines agents are also required to submit a copy of any policy and certain other information.<sup>16</sup> Surplus lines agents are required to maintain in their agency office for a period of 5 years each surplus lines contract, including applications and all certificates, and other detailed information about each surplus lines policy.<sup>17</sup>

Florida law also requires a surplus lines agent to file a quarterly affidavit with the FLSO to document all surplus lines insurance transacted in the quarter.<sup>18</sup> The affidavit also documents the efforts the agent made to place coverage with authorized insurers and the results of the efforts.<sup>19</sup> To account for the administrative costs surplus lines agents incur to comply with reporting requirements, the agent may charge a reasonable per-policy fee, not to exceed \$35, for each policy exported.<sup>20</sup> This fee has not been adjusted since it was raised from \$25 to \$35 in 2001.<sup>21</sup>

### *Effect of the Bill*

The bill removes the \$35 cap on the per-policy fee agents may charge for each exported policy. The fee must be reasonable and itemized separately before purchase and enumerated on the policy.

The bill eliminates the required quarterly affidavit. The FLSO receives relevant information electronically in ongoing data filings.

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<sup>12</sup> Personal residential policies include homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners, and similar policies.

<sup>13</sup> S. 626.914(1), F.S.

<sup>14</sup> S. 626.927, F.S. Generally, to be licensed as a surplus lines agent, an individual must be: (1) deemed by the Department of Financial Services to have sufficient experience in the insurance business (2) have 1-year experience working for a licensed surplus lines agent or have completed 60 class hours in an approved surplus lines course, and (3) pass a written examination.

<sup>15</sup> Ss. 626.921(2) and 626.931, F.S.

<sup>16</sup> S. 626.923, F.S.

<sup>17</sup> S. 626.930, F.S.

<sup>18</sup> FLORIDA SURPLUS LINES SERVICE OFFICE, *Quarterly Report Affidavit as Required by the Surplus Lines Law*, <https://www.flso.com/docs/default-source/default-document-library/BusinessForms/QuarterlyAffidavit.pdf?sfvrsn=24> (last visited Feb. 14, 2019).

<sup>19</sup> FLSO states that the affidavit is unnecessary and that they collect relevant information through electronic data filings. Email from Bryan Young, Assistant Director, Agent and Insurer Services, RE: HB 387 and affidavit (Feb. 15, 2019).

<sup>20</sup> S. 626.916(4), F.S.

<sup>21</sup> Ch. 2001-213, Laws of Fla.

## **Exportation of Flood Insurance Risks to the Surplus Lines Market**

### National Flood Insurance Program

The National Flood Insurance Program (NFIP) was created by the passage of the National Flood Insurance Act of 1968 to offer federally-subsidized flood insurance to property owners and to promote land-use controls in floodplains. The NFIP is administered by the Federal Emergency Management Agency (FEMA). The federal government will make flood insurance available within a community, if that community adopts and enforces a floodplain management ordinance to reduce future flood risk to new construction in floodplains.<sup>22</sup>

The NFIP charges less than actuarially sound rates and has been the subject of multiple federal acts to address the solvency of the NFIP and bring the rates to an actuarially sound level over time.<sup>23</sup>

Nationally, the NFIP insured about \$1.3 trillion in assets, as of Sept. 30, 2018, and had 1,770,452 Florida policies in force associated with \$974,338,089 in written premium.<sup>24</sup> The following table illustrates total policies in force and total earned premium for NFIP coverage reported countrywide for each calendar year since 2013.<sup>25</sup>

NFIP		
Calendar Year	Total Policies in Force	Total Earned Premium
2013	5,568,642	\$ 3,512,987,082
2014	5,406,725	\$ 3,542,524,781
2015	5,205,094	\$ 3,436,750,383
2016	5,081,470	\$ 3,332,142,136
2017	5,133,785	\$ 3,308,151,440

### Florida Surplus Lines Flood Insurance Market Size

The following table illustrates total policy count and total premium exported to the Florida surplus lines market each calendar year since 2013.<sup>26</sup>

<sup>22</sup> FEMA, *National Flood Insurance Program, Program Description*, (Aug. 1, 2002), <https://www.fema.gov/media-library/assets/documents/1150?id=1480> (last visited Feb. 15, 2019).

<sup>23</sup> FEMA, *National Flood Insurance Program: Laws & Regulations*, <https://www.fema.gov/national-flood-insurance-program-laws-regulations> (last visited Feb. 15, 2019).

<sup>24</sup> FEMA, *Policy Statistics*, <https://bsa.nfipstat.fema.gov/reports/1011.htm> (last visited Feb. 15, 2019).

<sup>25</sup> FEMA, *Statistics by Calendar Year*, <http://www.fema.gov/statistics-calendar-year> (last visited Feb. 15, 2019).

<sup>26</sup> FLORIDA SURPLUS LINES SERVICE OFFICE, *Florida Market Data, Surplus Lines Premium*,

<https://www.fluso.com/Florida/MarketData/surpluslinespremium> (last visited Feb. 15, 2019). Search date range Q1 to Q4 for each calendar year on coverage codes: Excess Flood – Commercial – 1016; Excess Flood – Personal – 2015; Flood – Commercial – 1010; and Flood – Personal – 2008.

Florida Surplus Lines Flood Market		
Calendar Year	Total Policy Count	Total Premium
2013	8,737	\$46,349,828
2014	10,190	\$57,237,766
2015	11,867	\$90,393,917
2016	20,681	\$83,785,736
2017	40,955	\$89,211,122
2018	47,130	\$110,312,262

#### Exportation of Flood Insurance is Exempt from Statutory Diligent Effort

To foster the development of a flood insurance market among admitted insurers, the Legislature created s. 627.715, F.S., governing the sale of personal lines residential flood insurance.<sup>27</sup> A flood insurer may establish rates through the standard process in s. 627.062, F.S., i.e., before implementation of the rate (“file and use” review) or shortly after implementation of the rate (“use and file” review). Alternatively, rates filed before October 1, 2025, may be established through an informational rate filing that is not required to be reviewed by OIR. Specifically, the flood rate is exempt from the “file and use” and “use and file” requirements of s. 627.062(2)(a), F.S. Such filings are also exempt from the requirement to provide information necessary to evaluate the company and the reasonableness of the rate.<sup>28</sup>

While the Florida admitted flood market develops, current law eases access to the surplus lines market for flood risks. A surplus lines agent can export a contract or endorsement for flood insurance without obtaining coverage rejections from the admitted market under an exception to the statutory diligent effort requirement.<sup>29</sup> Statutory diligent effort requires an agent to determine that the insurance is not available from an insurer currently writing in the state and limits any amount that may be exported to the amount in excess of the amount that can be procured in the state. Normally, the agent must document that he or she has made a diligent effort to procure the coverage from an admitted insurer.<sup>30</sup> This is one of five conditions currently applicable to agents who seek to export other lines of insurance. The four others relate to premium, the policy form, deductible amounts, and notice to an applicant of the availability of coverage from Citizens.<sup>31</sup> In general, the conditions prevent a surplus lines insurer, which is subject to substantially less regulation than an admitted insurer, from offering policies with terms and conditions that are more favorable than can be offered by an admitted insurer. This exemption from the statutory diligent effort requirement is scheduled for repeal July 1, 2019; however, if the Insurance Commissioner declares that an adequate admitted flood insurance market exists prior to July 1, 2019, this exception to the diligent effort requirement will end.<sup>32</sup>

<sup>27</sup> Ch. 2014-80, Laws of Fla.

<sup>28</sup> OIR may examine a rate filing at its discretion. To enable the office to conduct such examinations, insurers must maintain actuarial data related to flood coverage for two years after the effective date of the rate change. Upon examination, OIR will use actuarial techniques and the standards of the rating law to determine if the rate is excessive, inadequate or unfairly discriminatory. The law allows projected flood losses for personal residential property insurance to be a rating factor. Flood losses may be estimated using a model or straight average of models found reliable by the Florida Commission on Hurricane Loss Projection Methodology. S. 627.715, F.S.

<sup>29</sup> S. 626.916(1)(a), F.S.

<sup>30</sup> Section 626.914, F.S., defines “diligent effort” as seeking and being denied coverage from at least three authorized insurers in the admitted market, unless the cost to replace the property insured is \$1 million or more. In that case, diligent effort is seeking and being denied coverage from at least one authorized insurer in the admitted market.

<sup>31</sup> Current law prohibits Citizens from offering flood coverage. S. 626.916(6), F.S.

<sup>32</sup> OIR reports that, as of September 1, 2018, 29 insurers are eligible to write primary private flood insurance in Florida, which is a 45 percent increase since June 2017, and additional flood insurer admissions are pending. Email from Caitlin Murray, Director of Legislative Affairs, Florida Office of Insurance Regulation, RE: Status of the Florida Flood Insurance Market (Jan. 10, 2019).

The following table illustrates total policy count and total premium written in the Florida admitted market, as reported by OIR.<sup>33</sup>

Florida Admitted Flood Market		
As of	Total Policy Count	Total Premium
Jun. 30, 2017	26,585	n/a
Sept. 1, 2018	50,438	\$59,065,769

*Effect of the Bill*

The bill allows surplus lines agents to export flood insurance risk to the surplus lines market without obtaining coverage rejections from admitted insurers for an additional six years. The expiration date of the exemption is moved from July 1, 2019, to July 1, 2025. The exemption remains subject to an earlier termination upon the Insurance Commissioner declaring that an adequate admitted flood insurance exists.<sup>34</sup>

B. SECTION DIRECTORY:

**Section 1.** Amends s. 626.916, F.S., relating to eligibility for export.

**Section 2.** Amends s. 626.931, F.S., relating to agent affidavit and Insurer reporting requirements.

**Section 3.** Amends s. 626.932, F.S., surplus lines tax.

**Section 4.** Amends s. 626.935, F.S., relating to suspension, revocation, or refusal of surplus lines agent's license.

**Section 5.** Amends s. 627.715, F.S., relating to flood insurance.

**Section 6.** Amends s. 629.401, F.S., relating to insurance exchange.

**Section 7.** Providing an effective date of July 1, 2019.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

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<sup>33</sup> *Id.*

<sup>34</sup> In 2017, the Legislature extended this exemption for two years from July 1, 2017 to July 1, 2019. Ch. 2017-142, Laws of Fla.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Removing the \$35 cap on the per-policy fee allowed to surplus lines agents may result in increased fees paid by consumers, but could mitigate losses suffered by agents where the current fee is inadequate to cover the actual administrative costs of administering a policy.

The availability of placing flood insurance coverage in the surplus lines market may increase access to coverage for property owners, but could negatively affect the development of the Florida flood insurance market by allowing risks into the surplus lines without first having to be rejected by an admitted carrier(s).

D. FISCAL COMMENTS:

None.

### **III. COMMENTS**

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not Applicable. This bill does not appear to affect county or municipal government.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided by the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### **IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES**

On February 20, 2019, the Insurance & Banking Subcommittee considered the bill, adopted one amendment, and reported the bill favorably as a committee substitute. The amendment:

- Deletes the portion of the bill allowing Florida insureds that are purchasing a policy covering risks or exposures only partially in Florida and where Florida is the home state to choose between the premium tax rate of the other state or Florida's tax rate; this will maintain current law, which limits the tax rate to the lesser of Florida's tax rate or the tax rate of the other state;
- Eliminates cross-references consistent with changes made by the bill;
- Revises the effective date of the bill due to the elimination of a delayed effective date contained in the tax related portion of the bill, which is being removed in this amendment; and
- Makes technical changes to remove unnecessary language.

The staff analysis has been updated to reflect the committee substitute.