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**HOUSE OF REPRESENTATIVES
COMMITTEE ON
FINANCIAL SERVICES
BILL ANALYSIS & ECONOMIC IMPACT STATEMENT**

BILL #: CS/HB 269

RELATING TO: Surplus Lines Insurance

SPONSOR(S): Committee on Financial Services and Representative Bainter

STATUTE(S) AFFECTED: Chapter 626, Part VIII, and section 631.52, F.S.

COMPANION BILL(S): SB 908 (s)

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) FINANCIAL SERVICES YEAS 11 NAYS 0
- (2) GOVERNMENTAL OPERATIONS
- (3) FINANCE AND TAXATION
- (4)
- (5)

I. SUMMARY:

“Surplus lines insurance” is insurance coverage provided by an insurance company that is not licensed in Florida, but that is allowed to do business in the state because the particular coverage offered is not available from Florida-licensed companies.

The bill creates the Florida Surplus Lines Service Office as a private, nonprofit entity to supplement the regulatory functions of the Department of Insurance with respect to surplus lines insurance. The service office is required to maintain files of surplus lines policy forms, maintain records of surplus lines transactions, and collect and remit to the department the existing 5% tax on surplus lines premiums.

The service office will be funded by a fee in the amount of up to 0.3% on surplus lines premiums, as determined by the department, which will generate up to \$1.9 million a year. It will operate subject to a plan of operation approved or adopted by the department, and will be governed by a board appointed by the department.

The bill also provides circumstances under which certain surplus lines insurers may be subject to the minimum surplus requirements applicable to admitted insurers, rather than the higher requirements applicable to surplus lines insurers

The bill does not reduce any current regulatory functions of the department, and is therefore not expected to have any fiscal impact on the department.

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

“Surplus lines insurance” is insurance coverage provided by an insurance company that is not licensed in Florida, but that is allowed to do business in the state because the particular coverage offered is not available from Florida-licensed companies. Commercial general liability policies and similar policies typically exclude coverage for high-risk activities; a surplus lines policy provides a business with coverage for those activities. Hazardous materials transporters, day care centers, nuclear power plants, and taverns are among the kinds of businesses that usually need to obtain liability coverage in the surplus lines market. In 1995, Florida generated \$656 million in surplus lines premiums on approximately 175,000 policies.

When specific insurance coverages of subjects resident, located, or to be performed in Florida cannot be procured from authorized (i.e., Florida-licensed) insurers, the coverages are designated as “surplus lines.” Surplus lines coverage may be procured from unauthorized (i.e., not holding a Florida certificate of authority) insurers if the insurance is eligible for export (i.e., placement with a surplus lines insurer), the insurer is an eligible surplus lines insurer, the insurance is placed through a Florida-licensed surplus lines agent, and the other provisions of the surplus lines law, ss. 626.913-626.937, F.S., are complied with.

In general, insurance is eligible for export to surplus lines insurers if the full amount of insurance required cannot, after diligent effort by the agent, be procured from any admitted insurer (when some of the coverage can be procured from an admitted insurer, only the excess is eligible for export); if the premium is no lower than the rate actually in use by a majority of admitted insurers for the same coverage on a similar risk; if the policy form is no more favorable to the insured, as to coverage or rate, than the forms currently in use by a majority of admitted insurers; and if the policy contains no deductible other than those currently in use by any admitted insurer (except as to windstorm or as to extended coverage on a fire policy).

In order for an insurer to be an eligible surplus lines insurer, it must have been licensed in its state or country of domicile for at least three years (this requirement may be waived or shortened by the department), must have surplus (i.e., net worth) of at least \$15 million (this requirement is being phased in, with the 1997 surplus requirement equal to \$4.5 million), must have a good reputation, and must meet the trustworthiness and criminal history requirements that apply to admitted insurers under s. 624.404(3). By contrast, the required minimum surplus to maintain a certificate of authority as a property and casualty insurer is \$4 million (this requirement is also being phased in, and the 1997 requirement is \$1.95 million).

Surplus lines policies are subject to a 5% premium tax known as the “surplus lines tax,” which is collected by the surplus lines agent and remitted to the department on a quarterly basis. The Insurance Commissioner’s Regulatory Trust Fund, which is the source of Department of Insurance funding, receives 55% of the proceeds of the tax, and the General Revenue Fund receives the remaining 45%. The uses of the tax are not restricted to activities relating to surplus lines insurance.

Surplus lines agents play a key role in assuring compliance with the surplus lines laws. The agent must determine that the applicant qualifies for surplus lines coverage and that the surplus lines insurer is eligible. The agent must also file a quarterly report with the department which includes aggregate gross and net premiums and a listing of all policies issued. There is no automatic filing requirement for the policy forms themselves, but an agent must file a copy of a form upon request of the department. Agents are required to maintain certain records, which are subject to examination by the department.

Surplus lines policyholders are not protected by a guaranty association in the event of the insurer's insolvency; however, the surplus lines industry as a whole appears to be financially sound. According to a 1994 A. M. Best Co. solvency study, the annual average number of insolvencies among insurers as a whole from 1969 through 1993 was 0.87%, while the average number of surplus lines insolvencies was 0.80%.

Private, nonprofit "stamping offices" have been established in 10 states, including California, New York, Texas, and Illinois, to provide additional regulatory oversight of the surplus lines industry. The functions of these offices vary from state to state, but usually include the review of forms to determine whether they are in compliance with the statute, enhanced data collection, and calculation and collection of taxes. In 1996, the California stamping office raised \$5,558,000 in revenues and had expenses of \$5,158,499; a fee of 0.35% of premium generated \$5,350,000 of the office's revenues. The Texas stamping office raised \$1,279,000 and spent \$2,024,600 in 1996; a fee of 0.1% of premium generated \$1,100,000 of revenues.

B. EFFECT OF PROPOSED CHANGES:

Each surplus lines policyholder would pay a "surplus lines service fee" in the amount of up to 0.3 percent of the total gross premium of a filed surplus lines policy or document, as determined by the Department of Insurance. The fee would fund the Florida Surplus Lines Service Office, which would be created to supplement the regulatory functions of the Department of Insurance with respect to surplus lines insurance.

The Florida Surplus Lines Service Office would be a nonprofit association of which all surplus lines agents would be members. Agents would file with the service office a copy of, or information on, each surplus lines policy or other document required by the service office plan of operation. When the insurer or an adjuster representing the insurer received a claim notice under a policy subject to these filing requirements, the insurer or adjuster would notify the service office of the claim and the policy under which the claim was made. The service office would determine whether the policy was filed as required, and would report any unfiled policy to the department.

Subject to the Insurance Code and rules of the department, the service office would:

Receive, record, and review all surplus lines insurance policies or documents.

Maintain records of policies reported to the service office and provide monthly reports to the department.

Prepare quarterly reports of each surplus lines agent's business, and collect and remit to the department the surplus lines tax.

Reconcile reports from non-admitted insurers and surplus lines agents, and provide a report of the reconciliation to the department.

Submit to the department for its approval an annual operating budget for the office.

The office would operate under a board of governors appointed by the department, consisting of five members of the Florida Surplus Lines Association, a representative (who is a surplus lines agent) from each of the two major Florida associations of insurance agents, the Insurance Consumer Advocate, and a risk manager for a large domestic commercial enterprise.

The association must submit a plan of operation to the department. If the association fails to submit a suitable plan within 180 days after the effective date of the act, or if the association subsequently fails to submit suitable amendments, the department must adopt a plan, amendments, or rules to effectuate the act.

The department is given the power to examine the association as deemed necessary, at the association's expense.

The surplus lines association, the board, officers, agents, and employees of the association, and the department and its officers and employees would be immune from civil liability for actions taken by them in the performance of their duties under the section.

Information furnished under s. 626.923 or examined under s. 626.930 would continue to be confidential and exempt from the public records law. The bill adds a provision that this exemption does not apply to any proceeding instituted by the department against an agent or insurer.

The bill would also provide circumstances under which certain surplus lines insurers could be eligible to do business in Florida while maintaining the minimum surplus required of licensed insurers, rather than the higher minimum required of surplus lines insurers.

C. APPLICATION OF PRINCIPLES:

1. Less Government:

a. Does the bill create, increase or reduce, either directly or indirectly:

(1) any authority to make rules or adjudicate disputes?

The Department of Insurance is authorized to approve or adopt a plan of operation for the Surplus Lines Service Office.

- (2) any new responsibilities, obligations or work for other governmental or private organizations or individuals?

Yes. The bill creates a private, nonprofit entity to perform oversight functions not currently required by law.

- (3) any entitlement to a government service or benefit?

No.

- b. If an agency or program is eliminated or reduced:

- (1) what responsibilities, costs and powers are passed on to another program, agency, level of government, or private entity?

None. The bill would create a Surplus Lines Service Office to perform functions not currently performed by the Department of Insurance.

- (2) what is the cost of such responsibility at the new level/agency?

Not applicable.

- (3) how is the new agency accountable to the people governed?

Not applicable.

2. Lower Taxes:

- a. Does the bill increase anyone's taxes?

No.

- b. Does the bill require or authorize an increase in any fees?

Yes. Surplus lines policyholders would pay a fee of up to of 0.3% of gross premiums on all surplus lines policies to fund the operations of the Surplus Lines Service Office.

- c. Does the bill reduce total taxes, both rates and revenues?

No.

- d. Does the bill reduce total fees, both rates and revenues?

No.

- e. Does the bill authorize any fee or tax increase by any local government?

No.

3. Personal Responsibility:

- a. Does the bill reduce or eliminate an entitlement to government services or subsidy?

Not applicable.

- b. Do the beneficiaries of the legislation directly pay any portion of the cost of implementation and operation?

Policyholders, agents, and insurers all might benefit from the service office proposed in the bill. The fees to support the service office would be paid by policyholders.

4. Individual Freedom:

- a. Does the bill increase the allowable options of individuals or private organizations/associations to conduct their own affairs?

Not applicable.

- b. Does the bill prohibit, or create new government interference with, any presently lawful activity?

Not applicable.

5. Family Empowerment:

- a. If the bill purports to provide services to families or children:

- (1) Who evaluates the family's needs?

Not applicable.

- (2) Who makes the decisions?

Not applicable.

(3) Are private alternatives permitted?

Not applicable.

(4) Are families required to participate in a program?

Not applicable.

(5) Are families penalized for not participating in a program?

Not applicable.

b. Does the bill directly affect the legal rights and obligations between family members?

Not applicable.

c. If the bill creates or changes a program providing services to families or children, in which of the following does the bill vest control of the program, either through direct participation or appointment authority:

(1) parents and guardians?

Not applicable.

(2) service providers?

Not applicable.

(3) government employees/agencies?

Not applicable.

D. SECTION-BY-SECTION ANALYSIS:

Section 1 provides that the bill may be cited as the Dana Roehrig Act.

Section 2 amends s. 626.921, F.S., relating to confidentiality of records of the surplus lines examining office. Under s. 626.923, F.S., a surplus lines agent must furnish to the Department of Insurance a copy of any requested policy, certificate, application, endorsement, or similar document; under s. 626.930, F.S., the department may examine specified records of surplus lines agents. Section 626.921 currently provides that these records are exempt from disclosure under the public records law, s. 119.07(1), if disclosure would reveal a trade secret.

As described under "Effect of Proposed Changes," above, this section of the bill creates the Surplus Lines Service Office and a fee of up to 0.3%, as determined by the department, to fund the office. This section of the bill also preserves the substance of

the existing section relating to confidentiality of records of the surplus lines examining office.

Section 3 amends s. 626.931, F.S., relating to quarterly reports. Currently, surplus lines agents must file with the department quarterly reports of their surplus lines business, foreign (i.e., non-Florida) insurers must file with the department quarterly reports of surplus lines business, and alien (i.e., non-U.S.) insurers must file with the department annual reports of surplus lines business. Effective January 1, 1998, the bill requires these reports to be filed instead with the Surplus Lines Service Office.

Section 4 amends s. 626.932, F.S., relating to the surplus lines tax. As described in "Present Situation," above, surplus lines agents currently collect from policyholders and remit to the Department of Insurance a 5 percent tax on surplus lines premiums. The proceeds of this tax are divided between the Insurance Commissioner's Regulatory Trust Fund (55 percent) and the General Revenue Fund (45 percent). Currently, the surplus lines agent must remit the tax to the department on a quarterly basis. Effective January 1, 1998, the bill requires agents to instead remit the tax to the Surplus Lines Service Office, which is required to forward amounts collected to the department.

The bill also specifies that the new surplus lines service fee does not constitute "premium" for purposes of the surplus lines tax.

Section 5 creates s. 626.9325, F.S., relating to the surplus lines service fee. The bill provides that surplus lines policies are subject to the service fee of up to 0.3% specified in s. 626.921, F.S., which must be collected along with the full amount of the premium at the time of delivery of the policy or other initial confirmation of issuance. The surplus lines agent may not absorb the service fee and may not rebate the fee or any portion of the commission as an inducement for insurance or for any other reason. Fees must be remitted to the service office monthly, and delinquencies are subject to a 9 percent interest charge. The fees must be used to fund the cost of operations of the service office.

If the surplus lines policy covers risks or exposures only partly within Florida, the fee applies only to the Florida risks or exposures. The fee does not apply to policies covering state or local government agencies.

For purposes of this section, the term "premium" is defined to include both the premium and any fees charged, including the per-policy fee under s. 626.916, F.S., (but excluding the up to 0.3 percent service fee).

Section 6 amends s. 626.918, F.S., relating to standards for eligibility of surplus lines insurers. In 1993, the Legislature raised the minimum surplus required both of admitted insurers and surplus lines insurers. These increases are currently being phased in; the 1997 minimum surplus requirement for admitted property and casualty insurers is \$1.95 million, and the 1997 minimum surplus requirement for surplus lines insurers is \$4.5 million. A surplus lines insurer could elect to be subject to the minimum surplus requirements applicable to insurers generally, rather than the higher requirements applicable to surplus lines insurers, if three requirements are met:

The insurer must be a member of a holding company which also owns a Florida-domiciled admitted insurer.

The insurer must comply with Chapter 625, F.S., which governs insurers' accounting and investments.

The insurer must be a member of the Florida Insurance Guaranty Association.

Compliance with these requirements would provide the department with greater regulatory authority than it has with respect to surplus lines insurers generally, and would provide protection for the surplus lines insurer's policyholders in the event of insolvency.

Section 7 amends s. 631.52, F.S., relating to the scope of the Florida Insurance Guaranty Association law, to conform the bill to the changes made by Section 6.

Section 8 provides that the act takes effect October 1, 1997.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

None.

2. Recurring Effects:

The bill is not expected to have any fiscal impact on the Department of Insurance, because the Surplus Lines Service Office created by the bill will perform oversight and record collection functions that are not currently being performed by the department, and because the department will continue to perform its current regulatory functions.

3. Long Run Effects Other Than Normal Growth:

None.

4. Total Revenues and Expenditures:

See above.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

None.

2. Recurring Effects:

None.

3. Long Run Effects Other Than Normal Growth:

None.

C. **DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:**

1. Direct Private Sector Costs:

Surplus lines policyholders must pay, and surplus lines agents must remit to the Department of Insurance, a service fee of up to 0.3% on surplus lines premiums, as determined by the department, to fund the surplus lines service office. The fee will generate up to \$1.9 million in annual revenues to support the private, nonprofit service office.

To the extent that reduced surplus requirements for certain surplus lines insurers increase the likelihood of insolvencies that would be covered by the Florida Insurance Guaranty Association, the bill could increase the potential for assessments by the guaranty association.

2. Direct Private Sector Benefits:

To the extent that the Surplus Lines Service Office will allow for better enforcement of the Surplus Lines Law, consumer protection may be improved.

3. Effects on Competition, Private Enterprise and Employment Markets:

See above.

D. **FISCAL COMMENTS:**

Based on 1995 surplus lines premiums, the service fee of up to 0.3% included in the bill will generate up to \$1.9 million in annual revenues to support the service office. Revenues for fiscal year 1997-98 would be substantially lower than this amount, because the bill takes effect on October 1, 1997, and is not expected to be fully implemented until about six months after the effective date.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. **APPLICABILITY OF THE MANDATES PROVISION:**

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that counties and municipalities have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

CS/HB 269 is substantially the same as HB 269 as originally filed, except that the committee substitute:

includes a short title for the bill;

changes the amount of the service fee from 0.3% of premium to *up to* 0.3% of premium, as determined by the Department of Insurance;

provides a January 1, 1998, effective date for provisions relating to surplus lines agents' duty to file quarterly reports and to remit taxes to the Surplus Lines Service Office rather than the Department of Insurance; and

provides circumstances under which certain surplus lines insurers may be subject to the minimum surplus requirements applicable to admitted insurers, rather than the higher requirements applicable to surplus lines insurers.

VII. SIGNATURES:

COMMITTEE ON FINANCIAL SERVICES:

Prepared by:

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