

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 144

SPONSOR: Banking and Insurance Committee and Senator Campbell

SUBJECT: Property Insurance

DATE: April 24, 2000 REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Emrich</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	_____	_____	<u>AG</u>	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

## I. Summary:

Committee Substitute for Senate Bill 144 contains the following provisions:

- ▶ Repeals the option of binding arbitration as to disputes between property, casualty and surety insurance companies and the Department of Insurance over an insurer's rate filing. Under current law, all such insurers authorized to do business in Florida are required to file their premium rates charged for property insurance with the department. When an insurer, including the Florida Residential Property & Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA), is issued a notice of intent to disapprove a rate filing by the department, the insurer may request an administrative hearing under the Administrative Procedures Act or, in the alternative, binding arbitration of the rate filing under the Insurance Code. The effect of this bill would be that disputes between the insurer and the department over an insurer's rate filing could be conducted only through administrative litigation.
- ▶ Provides that the Florida Residential Property & Casualty Joint Underwriting Association (RPCJUA) shall not be assessed by the Florida Insurance Guaranty Association (FIGA) to fund claims of insolvent insurers unless a special assessment is necessary to fund a bond issue by FIGA.
- ▶ Requires the Department of Revenue to conduct a study evaluating alternatives to determining the method of calculating and distributing insurance premium taxes to municipalities and fire control districts for use in funding the firefighter pensions and municipal police pensions. The Department of Revenue must submit to the Legislature by February 1, 2001, a report containing the results of its study and any recommended legislation. Until July 1, 2001, the Department of Insurance would be prohibited from taking any action to audit insurers or to finalize any pending audits of insurers with respect to the accuracy of coding the location of insured properties for purposes associated with these premium taxes.

This bill amends the following sections of the Florida Statutes: 627.351, 631.54, and 631.57. This bill repeals section 627.062(6), Florida Statutes.

## II. Present Situation:

### Filing of Insurance Rates and Arbitration

Florida's insurance laws require insurers to file property and casualty insurance rates for approval with the department either 90 days before the proposed effective date or 30 days after the rate filing is implemented.<sup>1</sup> Under the latter option, however, the department may order the insurer to refund that portion of the rate determined to be excessive, so it is rarely utilized.<sup>2</sup> If the department disapproves a rate filing, the insurer may request an administrative hearing under the Administrative Procedures Act (ch. 120, F.S., APA). Under the APA, a company which disputes the material facts which are the basis for the department's rate decision may request a formal adversarial proceeding under s. 120.57(1), F.S. These proceedings are held before a State administrative law judge of the Division of Administrative Hearings. Once the hearing is completed, the judge issues his or her decision, termed a recommended order, to the Insurance Commissioner for final review. In turn, the Commissioner issues a final order, which may be appealed to the First District Court of Appeal.<sup>3</sup>

Until 1996, this process was the insurer's only administrative remedy, and the lengthy delay and perception that a court would be unlikely to reverse a final order of the department typically led to a consent agreement between the department and the insurer. In 1996, the law was amended to allow insurers to request arbitration of a rate filing as an alternative to an administrative hearing.<sup>4</sup> This provision does not apply to private passenger automobile insurance under s. 627.0651, F.S., to workers' compensation insurance under s. 627.072, F.S., or to health insurance under s. 627.410-627.411, F.S.

Under binding arbitration, after the department issues a notice of intent to disapprove a rate filing, the insurer may request arbitration before a panel of three arbitrators.<sup>5</sup> The panel is chosen as

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<sup>1</sup>A filing is considered a "file and use" filing if it is made at least 90 days before the proposed effective date. It is termed a "use and file" filing if rates are filed no later than 30 days after the effective date. The department may disapprove a rate filing if it determines such rates to be "excessive, inadequate, or unfairly discriminatory." In making its decision, the department considers a number of factors, including, but not limited to, the insurer's past and prospective loss experience, the insurer's expenses, the insurer's investment income, the cost of reinsurance, and the adequacy of loss reserves. Prior to approving or disapproving a rate filing, the department may request additional supporting information for the filing from the insurer.

<sup>2</sup> Section 627.062, F.S.

<sup>3</sup>The Commissioner, in the final order, may adopt the recommended order of the administrative judge or may reject or modify the conclusions of law contained in the recommended order. However, the Commissioner may not substitute findings of facts in the recommended order which were supported by competent substantial evidence (s. 627.0612, F.S.).

<sup>4</sup> Ch. 96-194, L.O.F., amending s. 627.062(6), F.S. Arbitration has been an option for insurers, including the Residential Property & Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA), since January 1, 1997.

<sup>5</sup> In 1997, the department adopted rules for arbitration (Rule 4-170.101-137, F.A.C.).

follows: one is selected by the insurer, one by the department, and the third is chosen by the two other arbitrators. An arbitrator must be certified by the American Arbitration Association and may not be the employee of any insurance company or insurance regulator. The procedures outlined in the Arbitration Code (chapter 682, F.S.) are applied to rate arbitration and the costs of arbitration are paid by the insurer. The decision of the panel constitutes the final approval of a rate filing.

Either party to the arbitration proceeding may apply to the circuit court to vacate or modify the panel's decision as provided in ss. 682.13 and 682.14, F.S. In general, grounds for vacating include corruption or fraud, evident partiality by a neutral arbitrator, and action beyond the arbitrators' powers or jurisdiction. Grounds for modification include miscalculations, errors as to form, and actions on matters not submitted for arbitration. Upon initiation of arbitration, the insurer waives all rights to challenge the action of the Department of Insurance under the APA or any other law; however, these rights are restored to the insurer if the arbitrators fail to act within 90 days after initiation of arbitration.

Since the inception of the arbitration provision, only five insurance companies and the FWUA have requested arbitration. The table below features the requested rate change and the final decision by the arbitration panel. According to the Department of Insurance, a few insurers have requested an administrative hearing during this same period and the majority of those insurers settled prior to hearing. Representatives with the department state that a total of 399 companies have made filings with rate level impact since the inception of arbitration.<sup>6</sup> Of that number, the department has issued 94 notices of intent to deny rate requests. In such cases, the insurers had the option of going to arbitration, an administrative hearing, or settling the rate dispute with the department through negotiations. Representatives with the department point out that even though only five insurers (and the FWUA) have requested arbitration, those companies represent some of the largest insurers in terms of market share in the state.

### Companies Requesting Arbitration Since Inception

Company Name	Filing Received	Filing Type	Requested Rate Change	Arbitration Decision
State Farm Fire & Casualty	May 5, 1997	File & Use	25.60%	25.60%
Fidelity & Casualty of New York (CNA)	August 14, 1997	Use & File	28.10%	Remand filing to Department <sup>7</sup>
Florida Windstorm Underwriting Assn.	August 25, 1997	File & Use	61.00%-(Phased in over 3 years)	12.0%

<sup>6</sup>From January 1, 1997 (the inception date of arbitration) through September 30, 1999. This figure reflects the number of rate filings for just homeowners and mobile homeowners.

<sup>7</sup>CNA filed its rates under the "use & file" system. The filing was remanded to the department, and the department subsequently issued a consent order approving a 12.8 percent increase. CNA was prohibited from filing a homeowners rate increase prior to January 2000.

United Services Auto. Assn./USAA Casualty Insurance Company	September 2, 1997	File & Use	19.40%	14.80%
Nationwide	December 17, 1998	File & Use	27.00%	17.5%
Florida Windstorm Underwriting Assn	May 3, 1999	File & Use	106.10%	106.10% **
First Floridian	June 19, 1999	File & Use	17.20%	Still in Arbitration

\*\*The FWUA rate increase would be effective in July 2000. The maximum rate increase would be capped at 20 percent for the first year, 30 percent for the second year, and 40 percent for each subsequent year. The FWUA would be required to apply discounts, thus lowering the amount of premium paid, for loss mitigation retroactively to policyholders who mitigate their homes. The FWUA offers various cost saving features so that insureds could receive a fiscal incentive to retrofit their home, or where feasible, include retrofitting features in the construction of a new home. Finally, the actual premium impact is estimated to be 96 percent, but the 106.10 percent reflects the rate impact of reductions in coverage included in the filing.

Insurance companies prefer arbitration over administrative hearing litigation because, according to insurance officials, it is more efficient, cost-effective and much quicker. Industry representatives claim that with arbitration they can expect a resolution of the rate dispute within three months, as opposed to nine months to a year (if there is an appeal) in administrative litigation. Also, an insurer choosing arbitration has the opportunity to appoint an arbitrator familiar with rate making and the insurance industry generally. By contrast, Administrative Law Judges hear a great variety of administrative cases and often have no background in insurance. Finally, it is argued that the arbitration panel procedure takes rate-making decisions out of the realm of politics.

Proponents of this bill assert that from a public policy perspective, the elected Insurance Commissioner, and not an arbitration panel, should be the final rate-setting authority. Further, that consumers expect their elected insurance representative to represent their interests, as opposed to insurance companies, when insurers seek rate increases. Such persons claim that the recent arbitration decision to grant a substantial rate increase for the FWUA justifies their position.

**Florida Insurance Guaranty Association**

When an insurer becomes insolvent, all Florida insureds become responsible for the payment of claims against insolvent insurers through the Florida Insurance Guaranty Association (FIGA) assessments.<sup>8</sup> The current FIGA assessment is capped at 2 percent and the present total dollar amount for a one year assessment would be \$124 million. If claims of insolvent insurers exceed this amount, the Legislature would be forced to authorize special assessments to fund claims of insolvent insurers, or such claims would remain unpaid.

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<sup>8</sup>S. 631.50, F.S. FIGA is capped at \$300,000 per covered claim.

## Florida Residential and Casualty Joint Underwriting Association

The Legislature has created two insurance entities to sell property insurance coverage to persons who cannot obtain coverage in the private voluntary market: the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA). The RPCJUA provides residential property insurance statewide, insuring all perils covered under a standard residential policy (except in FWUA-eligible areas, where a RPCJUA policy excludes windstorm coverage). All insurers writing homeowners' insurance in Florida must participate in the RPCJUA and are liable for deficit assessments on a market-share basis. The Florida Windstorm Underwriting Association (FWUA) offers only windstorm coverage, and only in designated coastal areas. These two insurers depend upon debt financing to pay claims in the event of a major hurricane, secured by premium assessments on all property insurance policies in the state.

The legislative enactment of the RPCJUA in the Special Session of December 1992, was a direct response to the severe market disruption following the massive damage to property caused by the August 1992, storm known as Hurricane Andrew.<sup>9</sup> A key provision in the 1992 legislation was authorizing DOI to activate the RPCJUA for the purposes of insuring unrepaired hurricane-damaged property that had been insured by insolvent insurers. In the aftermath of Hurricane Andrew, 11 insurers became insolvent and it was necessary for the Legislature to also provide for the issuance of up to \$500 million in tax free municipal bonds to fund the shortfall of FIGA caused by these Hurricane Andrew-related insolvencies.<sup>10</sup> The bonds, issued by the City of Homestead, were financed by a special FIGA assessment on insurers of up to 2 percent of premiums written on all lines of property and casualty insurance, except automobile and workers' compensation.<sup>11</sup> Insurers were allowed to pass these assessments on to policyholders through premium increases.

A critical issue raised prior to the issuance of the bonds was the concern by the bond underwriters that the RPCJUA should be assessed by FIGA, like other property insurers, to pay for these bonds. Traditionally, residual market mechanisms like the RPCJUA are not members of guaranty associations. However, given the number of policies within the RPCJUA, it was necessary for "alternative programs" to be developed to allow FIGA to more expeditiously and effectively provide for the payment of these bonds.<sup>12</sup> Therefore, DOI issued a certificate of authority to the RPCJUA in early 1993, to allow the association to be an "insurer" for the purposes of FIGA assessments. In 1997, the bonds were paid off.

As of March 31, 2000, the RPCJUA has 62,230 policies representing exposures of \$10.5 billion, which is a significant decrease in policies over the past 3 ½ years from 936,837 policies in force and \$98 billion in insured value in September 1996. The estimated probable maximum loss (PML)

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<sup>9</sup> Chapter 92-345, Laws of Fla; currently in s. 627.351(6), F.S.,

<sup>10</sup>S. 631.57(3), F.S. and s. 166.111, F.S.

<sup>11</sup>In February 1993, the city issued \$473 million in bonds.

<sup>12</sup>Ch. 92-345, L.O.F.

is \$715 million for a 100-year storm. (The PML is an insurer's single greatest loss that is probable over a specified period of time.)

### **Premium Tax Distribution**

Under current law, insurers writing property and casualty premiums in Florida are required to annually pay to the Florida Department of Revenue (DOR), on or before March 1st, a tax on insurance premiums received during the preceding calendar year.<sup>13</sup> Participating city pension plans and special fire control district pension plans are eligible to receive annual distributions of these premium tax dollars on insurance policies written within the city limits or boundaries (in the case of fire districts) of the participating plan. Under the provisions of ch. 175, F.S., (Firefighter Pension Law), the amount of premium taxes collected is equal to 1.85 percent of all property insurance written within the city limits or boundaries (in the case of fire districts) of the participating plan.<sup>14</sup> Pursuant to ch. 185, F.S. (Municipal Police Pension Law), a 0.85 percent tax is imposed on all casualty insurance premiums written within the city limits of the participating plan.<sup>15</sup> The premium taxes collected by DOR are transferred to the Police Officers' and Firefighters' Premium Tax Trust Fund at the Division of Retirement. These funds are then available for distribution to the participating pension plans on an annual basis. For calendar year 1999, \$84 million was distributed to the 378 pension funds in the state (\$39 million to the firefighters' and \$45 million to the police pension funds).

Along with the reporting of premium taxes, insurers must annually report the geographic location of its insured risks to DOR. Each policy must properly identify both the municipality and fire district serving the geographic location of the policy, at the time of issuance of the insurance policy and at the time of each renewal. In other words, each policy must be coded with the proper identifying fire district or municipality code in order for the DOR to make accurate distribution of premium tax allocations to the various police and firefighter pension funds.

According to representatives with the Department of Insurance (DOI), complaints have been received alleging that insurers are not accurately coding their risks when they report this information to DOR. As a result, DOI has contemplated imposing administrative fines or other penalties against insurers. Furthermore, cities and fire control districts complain that the current coding method results in some participating municipalities and fire control districts receiving a disproportionate share of the premium tax, to the detriment of other cities and fire control districts.

Insurance companies respond that it is very difficult to accurately pinpoint the location of insured properties for a number of reasons. For example, oftentimes the boundaries of cities or fire districts change or the billing address may be different from the actual address of the insured property. Additionally, incorrect information may be given by the insured to the insurance agent as to what fire control district incorporates the insured property. Further, insurers argue that

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<sup>13</sup>S. 624.509, F.S.

<sup>14</sup>S. 175.101, F.S.

<sup>15</sup>S. 185.07, F.S.

proper coding is costly. For example, one insurer offered that it costs \$2.50 a policy to purchase the sophisticated software which is necessary to accurately code its risks. Also, DOI is auditing insurers as (part of its market conduct examinations) as to the accuracy of coding the location of insured properties at an estimated cost to insurers of \$.20 a policy.

### **III. Effect of Proposed Changes:**

**Section 1.** Amends s. 627.351, F.S., relating to the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA), to remove the authority from the RPCJUA and the FWUA to submit a rate filing dispute with the department to binding arbitration.

**Section 2.** Amends s. 631.54, F.S., to revise the definition of the terms “covered claim” and “member insurer” for the purposes of the Florida Insurance Guaranty Association (FIGA). It provides a “covered claim” shall not include any amount due from the RPCJUA or any other underwriting association as contribution or indemnification. A “member insurer” shall not include the RPCJUA formed pursuant to 627.351, F.S.

**Section 3.** Amends s. 631.57, F.S., to specify that the RPCJUA shall be exempt from all assessments by FIGA, except the RPCJUA shall be required to pay all assessments levied by FIGA to secure bonds to pay covered claims of insolvent insurers caused by or related to any hurricane. Any assessment levied must be in proportion that the RPCJUA’s net direct written premium in Florida in the classes protected by the account bears to the total of the net direct written premiums received in this state by all insurers for the preceding year for all coverages listed under s. 631.55(2), F.S. Section 631.55(2), F.S., refers to the three accounts within FIGA which are the auto liability account, the auto physical damage account, and the account for all other insurance.

The effect of this amendment will allow the RPCJUA to avoid being assessed by FIGA for non-hurricane assessments. By assessing both the RPCJUA and member insurers, FIGA is essentially assessing insurance companies twice, since insurers are already assessed by the RPCJUA.

**Section 4.** Amends s. 627.062, F.S., to repeal subsection (6) which allows insurers, in lieu of demanding an administrative hearing, to request arbitration of the rate filing.

**Section 5.** Creates an unspecified section to require the Department of Revenue to conduct a study evaluating alternatives to determining the method of calculating and distributing insurance premium taxes to municipalities and fire control districts for use in funding the firefighter pensions and municipal police pensions. The Department must submit to the Legislature by February 1, 2001, a report containing the results of its study and any recommended legislation. Until July 1, 2001, the Department of Insurance would be prohibited from taking any action to audit insurers or to finalize any pending audits of insurers with respect to the accuracy of coding the location of insured properties for purposes associated with these premium taxes.

**Section 6.** Provides for an effective date of October 1, 2000.

**IV. Constitutional Issues:**

## A. Municipality/County Mandates Restrictions:

None.

## B. Public Records/Open Meetings Issues:

None.

## C. Trust Funds Restrictions:

None.

**V. Economic Impact and Fiscal Note:**

## A. Tax/Fee Issues:

None.

## B. Private Sector Impact:

Based on the assumption that an arbitration panel is more likely to grant a rate increase, or that such a rate increase would be approved more quickly, the bill would have the effect of reducing the impact of rate increases for property and casualty policyholders. Conversely, insurers would be less likely or able to obtain what they consider to be adequate rates or to obtain a quick resolution of a rate filing. This could have the detrimental impact on consumers of reducing the availability of coverage if insurers are less willing or able to write new policies.

## C. Government Sector Impact:

The Division of Administrative Hearings may have more rate hearings as a result of the passage of this bill.

Representatives with the Department of Revenue state that the mandated study under section 5 of the bill will have no fiscal impact on the department.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.



**VIII. Amendments:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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