

STORAGE NAME: h0021.in
DATE: September 3, 1999

**HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS**

BILL #: HB 21
RELATING TO: Premium Security Deposits
SPONSOR(S): Representative Ogles

COMPANION BILL(S):

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

- (1) INSURANCE
 - (2)
 - (3)
 - (4)
 - (5)
-

I. SUMMARY:

Generally speaking, a security deposit is a form of collateral paid to ensure some later performance under an agreement or contract. For example, most landlords require tenants to pay a security deposit which is intended to ensure the tenant will meet the obligations of the lease. Similarly, some insurers require policyholders to pay a premium security deposit in instances where the total premium owed under the policy may not be known until a later date. Currently, Florida law does not expressly prohibit or authorize the use of premium security deposits.

Under this bill, insurers would be expressly authorized by law to accept and hold premium security deposits made by a policyholder under an insurance contract. Insurers holding a premium security deposit would also be authorized to pay interest to the policyholder on the premium security deposit.

In addition, the bill would require premium security deposits to be treated as a "covered claim" under the Florida Insurance Guaranty Fund and the Florida Workers' Compensation Insurance Guaranty Fund. Therefore, if an insurer became insolvent, the insured could recover the premium security deposit from the applicable guaranty fund.

According to the Department of Insurance, this bill will have no fiscal impact on state or local government.

II. SUBSTANTIVE ANALYSIS:

A. PRESENT SITUATION:

Security Deposits Generally

Generally speaking, a security deposit is a form of collateral paid to ensure some later performance under an agreement or contract. For example, most landlords require tenants to pay a security deposit which is intended to ensure the tenant will meet the obligations of the lease.

Insurance Contracts

Insurance contracts are regulated under Part II of Chapter 627, F.S. Excluded from regulation under this part are the following: reinsurance, insurance policies not issued for delivery in this state, wet marine and transportation insurance, and credit life or credit life disability insurance.

Nothing under this part, or any other part of statute, expressly prohibits or authorizes the use of premium security deposits. Premium security deposits can be thought of as collateral put up, or monies pledged, for the purpose of paying any additional premium owed an insurer.

The Use of Premium Security Deposits

Certain property and casualty insurance policies require insureds to pay a premium security deposit. Insurers use premium security deposits (sometimes referred to as "deposit premium") to secure payment of premium in instances where the actual amount of premium owed may not be known until the end of the policy period. For example, the Florida Workers' Compensation Joint Underwriting Association requires an insured to pay a deposit premium "to secure or renew coverage in the FWCJUA."¹ According to the FWCJUA Operations Manual, "at final audit, the deposit (is) applied to any earned premium due. . . ."² The deposit amount is based on the total estimated annual premium.

Premium security deposits are also used in connection with retrospective ("retro") rating plans. Under "retro" plans, the actual premium payable by the insured is not determined until the end of the policy term. This "retrospective premium," calculated based on the insureds actual loss experience, may differ considerably from the original or "standard" premium. For example, the standard premium may be \$1 million. However, under a "retro" plan, the insurer may require the insured to pay a premium of only \$200,000, subject to payment of additional premium at the end of the policy period and based on the actual loss experience. In exchange, the insurer may require the insured to post a premium security deposit to guarantee payment if the insured is found to owe additional premium.

Premium security deposits are also utilized in commercial general liability insurance. According to the contract of at least one insurer which treats "advance premium" as a "deposit premium," if the sum of the advance premium and audit premium exceeds the amount of earned premium, then the insurer will return the excess to the insured.

The Form of Premium Security Deposits

Insurers may require one of several forms of premium security deposit. For example, one domestic insurer requires the insurer to submit a performance or security bond, a certificate of deposit, or a letter of credit (LOC).³ One foreign insurer requires the insured to deliver a letter of credit to the insurer.

¹Part Six, D.2., Florida Workers' Compensation Joint Underwriting Association Operations Manual.

²Id.

³ In this context, banks refer to this type of letter of credit as a standby LOC. A standby LOC is an engagement by a bank or other person made at the request of a customer and of a kind that the issuer will honor drafts or other demands of payment upon compliance with the conditions specified in the LOC. Banks generally charge an issuance fee to the insured. The letter obligates the bank to pay the insurer upon the presentation of the draft drawn in accordance with terms of the credit and documents complying with the specifications in the credit.

Guaranty Funds and "Covered Claims"

The Legislature has created mechanisms to provide for the payment of "covered claims" under insurance contracts. These are intended "to avoid financial loss to claimants or because of the insolvency of a member insurer." Two of these are the Florida Insurance Guaranty Association and the Florida Workers' Compensation Insurance Guaranty Association.

To the extent a premium security deposit is not considered "premium," whether earned or unearned, then it would not be a "covered claim" under the Florida Insurance Guaranty Association Act and the Florida Workers' Compensation Insurance Guaranty Association Act. As such, an insured could not recover the amount of his or her deposit. To the extent a premium security deposit is considered unearned premium, an insured could have a covered claim and be able to recover from the guaranty funds. Under both acts, a "covered claim" is an unpaid claim, including one of unearned premiums, which arises out of, and is within the coverage, and not in excess of the applicable limits of an insurance policy.⁴

Insurance Premium Tax

Insurers are subject to payment of a premium tax under s. 624.509, F.S. The tax is imposed on insurance premiums *received* during the preceding calendar year. Insurers may be eligible for various credits or deductions against the amount the amount of the tax owed.

B. EFFECT OF PROPOSED CHANGES:

Insurers would be expressly authorized by law to accept and hold premium security deposits made by an insured under an insurance contract. The insurer would be authorized to pay interest to the insured on the premium security deposit of a variable or fixed amount.

Premium security deposits would be treated as a "covered claim" under the Florida Insurance Guaranty Fund and the Florida Workers' Compensation Insurance Guaranty Fund. Therefore, if an insurer became insolvent, the insured could recover the premium security deposit from the applicable guaranty fund.

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?

No.

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

No

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

No

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

⁴ The definitions of "covered claim" for the FIGA (s. 631.54(3), F.S.) and for the FWCIGA (s. 631.904(2), F.S.) are almost identical.

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

N/A

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

N/A

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

N/A

2. Lower Taxes:

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

No

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

No

- 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?

N/A

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

N/A

4. Individual Freedom:

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

Yes. Insureds would be permitted to provide a premium security deposit directly through the insurer providing coverage rather than through a third party such as a bank in the form of a letter of credit or security bond.

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

N/A

5. Family Empowerment:

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

(1) Who evaluates the family's needs?

N/A

(2) Who makes the decisions?

N/A

(3) Are private alternatives permitted?

N/A

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

N/A

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

N/A

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

N/A

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?

N/A

(2) service providers?

N/A

(3) government employees/agencies?

N/A

D. STATUTE(S) AFFECTED:

Creates s. 627.4045, F. S.

E. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE AGENCIES/STATE FUNDS:

1. Non-recurring Effects:

N/A

2. Recurring Effects:

N/A

3. Long Run Effects Other Than Normal Growth:

N/A

4. Total Revenues and Expenditures:

Under the bill, premium security deposits would not be considered "premium" for purposes of the insurance premium tax until used by the insurer to pay any earned premium obligation of the insured. Consequently, the bill should have no fiscal impact on state premium tax revenues.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS AS A WHOLE:

1. Non-recurring Effects:

N/A

2. Recurring Effects:

N/A

3. Long Run Effects Other Than Normal Growth:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

1. Direct Private Sector Costs:

Permitting insurers to accept and hold security deposits and pay interest to the insured could have a minimal negative fiscal impact on financial institutions. For instance, if insureds choose to deposit funds with an insured rather than submit a letter of credit, banks would lose associated fee revenues of an indeterminate amount.

2. Direct Private Sector Benefits:

Insureds could be spared the expense associated with securing a bond or letter of credit in order to satisfy any requirements to post a security deposit.

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

N/A

D. FISCAL COMMENTS:

The Department of Insurance does not project any fiscal impact upon the state.

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.

STORAGE NAME: h0021.in

DATE: September 3, 1999

PAGE 7

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that municipalities or counties 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:

HB 21 is identical to the original filed version of HB 791 by Representative Dockery from the 1999 session. In the 1999 session, HB 791 was slightly modified by the adoption of clarifying amendments by the Committee on Insurance and the Committee on Business Regulation and Consumer Affairs. Then, HB 791, 1st Engrossed, passed the House. Staff is preparing amendments at the sponsor's request which would conform HB 21 to the version that passed the House in the 1999 session (HB 791, 1st Engrossed). These amendments: (1) revise the proposed definition of premium security deposits so that it only applies in the context of commercial property and casualty insurance, including worker's compensation and employer liability coverage; (2) clarify when a premium security deposit would become taxable under s. 624.509, F.S.; and (3) clarify that this legislation will not impact premium financing.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:

Staff Director:

Robert E. Wolfe, Jr.

Stephen Hogge