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HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS

BILL #: HB 2295

RELATING TO: Credit and mortgage guaranty insurance

SPONSOR(S): Representative Jones

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:
(1) INSURANCE
(2) FINANCIAL SERVICES
(3)
(4)
(5)

I. SUMMARY:

Credit-based limited lines of insurance

Entities licensed to sell credit life or disability insurance could obtain a single credit license also allowing them to sell credit property insurance and credit insurance. Language prohibiting financial institutions licensed to sell credit life or disability insurance from selling credit property insurance would no removed. Entities also would no longer be required to obtain a license or appointment for each office or branch office. However, the licensed entity would be required to provide the Department of Insurance with the address and telephone number of each place of business selling credit insurance. Licensed entities would be required to post a copy of the license at each business location in which employees sell any of the credit-based insurance products, in lieu of posting it at each location issued a license as is currently required.

If credit life insurance is sold over the telephone: 1) agents would have 30 days from the date the policy takes effect, rather than prior to the sale of the coverage as the law now requires, to make required disclosures, and 2) agents would not have to obtain a written acknowledgment of these required disclosures from the borrower as is currently required. The borrower would be allowed to rescind the coverage 30 days from the date the disclosures were received.

Mortgage guaranty insurance

Mortgage guaranty insurers would be permitted to exclude contingency reserves from total liabilities when demonstrating compliance with the minimum surplus required based on the percentage of total liabilities rather than the flat $4 million minimum.

Based on data available as of December 31, 1999, for the 22 companies writing mortgage guaranty insurance, the total required minimum surplus under current law was $673.7 million. By excluding contingency reserves from liabilities, the total required minimum surplus would be $338.6 million, a $335.1 million reduction in required minimum surplus.

However, mortgage guaranty insurers would be required to have sufficient capital and surplus so that the total outstanding aggregate *exposure*, rather than *liability* as under current law, net of reinsurance under their written policies, would not exceed 25 times its paid capital, surplus, and contingency reserve combined.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1. Less Government Yes [] No [] N/A []
2. Lower Taxes Yes [] No [] N/A []
3. Individual Freedom Yes [] No [] N/A []
4. Personal Responsibility Yes [] No [] N/A []
5. Family Empowerment Yes [] No [] N/A []

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Credit-based limited lines of insurance

The Department of Insurance issues limited licenses for three different types of credit-based insurance products: credit life or disability, credit property, and credit insurance.[1] Virtually all licenses are issued to entities such as retail merchants, automobile dealerships, or finance companies, rather than to individuals. Each branch office or place of business of the entity must obtain a license to sell the insurance product and post the license in a visible location. Licensees, whether an individual or entity, are appointed by an insurer to market the particular insurance product at their place of business. Applicants for these limited licenses must undergo a background investigation and submit a set of fingerprints.[2] Applicants are not required to take a licensure examination or, once licensed, take continuing education courses. Limited lines agents may not hold a license as an agent for any other kind or class of insurance.

>*Credit life or disability insurance* covers a credit holder's debt in case of death or disability. Both individuals and entities can be licensed to sell this product. An individual seeking a limited license to sell credit life or disability insurance must be:

employed by a life or health insurer as an officer or other salaried or commissioned representative, or

employed by or associated with a lending or financial institution or creditor, and marketed only to borrowers or debtors of these institutions or creditors.

Except for financial institutions, entities which hold a credit life or disability license also may sell credit property insurance. The entity selling credit life or disability insurance is required to submit only one license application. The entity must obtain a license for each office, branch office, or place of business and pay the required appointment fees.

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[1]Section 626.321, F.S.

[2]If the applicant is an entity rather than an individual, fingerprints are submitted for officers, directors, sole proprietors, majority owners or partners.

However, these entities are not required to pay additional application fees for licenses issued to these offices or branches.

Agents selling credit life insurance must make certain disclosures to purchasers and must obtain a separate written acknowledgment from the borrower that the borrower understands that the coverage is not needed to obtain the loan, that the coverage may be deferred, and that the coverage will be terminated when the borrower reaches a certain age.[3]

>*Credit property insurance* insures against the loss of personal property used as collateral for securing a loan or on personal property purchased under an installment sales agreement.[4] Any individual, other than an employee of a financial institution, may be licensed to sell this insurance product. Except for financial institutions, entities holding a license to sell credit life or disability insurance also may be licensed to sell credit property insurance.

>*Credit insurance* covers loss or damage resulting from the failure of debtors to pay their obligations to creditors (including loss or damage resulting from the involuntary unemployment of the debtors).[5] The licensing provisions for entities licensed as credit life or disability apply to entities licensed as credit insurance agents. Apparently, then, both individuals and entities may be licensed to sell this product subject to the same limitations as apply to credit life or disability licensees. It is unclear if this means financial institutions can or cannot be licensed to sell this product. Nonetheless, some financial institutions do enter into “debt cancellation/deferment agreements” with borrowers. Under these agreements, the financial institution will cancel or suspend a debt in the event of the death, unemployment, or disability of the borrower. Unlike credit insurance, these agreements are not regulated as insurance products.

Regardless of the type of limited license, license application fees can cost approximately $150. License fees for a branch office of an entity applicant can run approximately $50. Total fees for limited appointments,[6] original and biennial renewal, are $60 per appointment. Of this amount, $42 is the appointment fee paid to the Department of Insurance, $12 is state tax, and $6 is county tax.

Mortgage guaranty insurance

Mortgage guaranty insurance protects a lender, usually a bank or mortgage company, against loss of all or a portion of the principal amount of a mortgage loan upon the default of the homeowner. This type of insurance provides no protection other than against loss due to default, and is regulated by the Department of Insurance under Chapter 635, in addition to other applicable provisions of the Insurance Code (e.g., s. 624.408). According to the National Association of Insurance Commissioners (NAIC), most policies cover from 10 to 30 percent of the loan amount and are written on first mortgage loans that represent a

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[3]Section 627.679, F.S.

[4]Section 624.605(1)(j), F.S.

[5]Section 624.605(1)(l), F.S.

[6]A “license” is “a document issued by the department authorizing a person to be appointed to transact insurance or adjust claims for the classes of insurance identified in the document.” An “appointment” is “authority given by an insurer or employer to a licensee to transact insurance or adjust claims on behalf of an insurer or employer.” Sections 626.103 and 626.104, F.S., respectively.

generally 80 to 95 percent of the value of the mortgaged property (NAIC publication: *Mortgage Guaranty Insurance Accounting Principles Supplement)*.

Licensed agents market mortgage guaranty insurance directly to mortgage lenders (e.g., banks, mortgage companies, credit unions, and state and local housing authorities). Lenders obtain mortgage guaranty insurance in order to facilitate the sale of mortgage loans in the secondary markets (i.e., markets in which securities are sold after their original issue).

The nature of the insured risk for mortgage guaranty insurance is influenced by certain factors which set such insurance in some respects apart from other types of insurance. For example, the exposure period for a particular risk is significantly longer for mortgage guaranty insurance.[7] Further, coverage is renewable at the option of the insured and at the rate quoted when the policy was originally issued. In part because mortgage guaranty insurance is guaranteed renewable at a definite rate, insurers establish a so-called "contingency reserve."

Minimum surplus requirements

As are other insurers, mortgage guaranty insurers must comply with statutorily-prescribed minimum surplus and capital requirements. Minimum surplus must be equivalent to the greater of 10 percent of the insurer's liabilities, or $4 million.[8] No insurer is required to have more than $100 million in surplus. In determining the required minimum surplus, specified liabilities are charged against certain assets; a mortgage guaranty insurer's contingency reserve is counted as a liability.

Under Florida law, a "contingency reserve" is a special premium reserve distinct from other premium reserves required by law. It is "established for the protection of policyholders against the effect of adverse economic cycles."[9] A contingency reserve must be established by each mortgage guaranty insurance company as a solvency requirement to protect policyholders against the effect of adverse economic conditions.[10] Each insurer must contribute an amount equal to 50 percent of earned premiums on each policy written into a contingency reserve and maintain such reserve over 10 years. In other words, insurers must set aside 50 cents of each premium dollar earned and maintain the contingency reserve for a period of 10 years, regardless of the length of coverage of the particular policy for which the premium was paid. The reserve may be reduced within this 10-year period only when losses in a calendar year exceed 35 percent of earned premiums.

According to the Department of Insurance, in the past five years, there has been only one instance in which the Department of Insurance has found a mortgage guaranty insurer out of compliance in violation of minimum surplus requirements. In this instance, the company had listed approximately $1 billion in liabilities and $95 million in surplus, thus short of the minimum required surplus (i.e., 10 percent of liabilities) by approximately $5 million

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[7]According to the NAIC, the average policy life is 7 years.

[8]Section 624.408, F.S. For property and casualty insurers holding a certificate of authority on December 1, 1993, the required minimum surplus based on a flat dollar amount is phased in through December 31, 2004. Currently, the amount is $2.5 million for these insurers using this basis for showing compliance with minimum surplus requirements..

[9]Section 635.011, F.S.

[10]Section 635.011, F.S.

according to the Department of Insurance.[11] The insurer had reported a contingency reserve of over $740 million. The Department of Insurance did not permit the company to exclude the contingency reserve from liabilities for purposes of determining the required minimum surplus. If the contingency reserve could have been excluded from total liabilities, the insurer's surplus would have been well in excess of the required minimum surplus requirements. Its total liabilities, excluding the contingency reserve, were $260 million; 10 percent of this amount would have been $26 million.

Florida's approach in determining the amount of minimum surplus required of an insurer apparently is more formula-driven than that used in many states. The minimum surplus requirement in many states is based on a flat dollar amount rather than a percentage of liabilities, with the insurance regulator having more discretion to modify the minimum amount of surplus required.

The Florida Insurance Guaranty Association (which pays policyholder claims when companies become insolvent) does not cover mortgage guaranty insurance.

Maximum outstanding liabilities

Mortgage guaranty insurers are prohibited from having outstanding total liabilities under its aggregate mortgage guaranty insurance policies, net of reinsurance, exceeding 25 times its paid-in capital, surplus, and contingency reserve combined.[12]

C. EFFECT OF PROPOSED CHANGES:

Credit-based limited lines insurance

Entities licensed to sell credit life or disability insurance could obtain a single credit license also allowing them to sell credit property insurance and credit insurance. Language prohibiting financial institutions licensed to sell credit life or disability insurance from selling credit property insurance would no removed. Entities also would no longer be required to obtain a license or appointment for each office or branch office. However, the licensed entity would be required to provide the Department of Insurance with the address and telephone number of each place of business selling credit insurance. Licensed entities would be required to post a copy of the license at each business location in which employees sell any of the credit-based insurance products, in lieu of posting it at each location issued a license as is currently required.

If credit life insurance is sold over the telephone: 1) agents would have 30 days from the date the policy takes effect, rather than prior to the sale of the coverage as the law now requires, to make required disclosures, and 2) agents would not have to obtain a written acknowledgment of these required disclosures from the borrower as is currently required. The borrower would be allowed to rescind the coverage 30 days from the date the disclosures were received.

Mortgage guaranty insurance

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[11]The insurer argued that an insurer's contingency reserve "is excluded from 'total liabilities' when computing the insurer's minimum surplus."

[12]Section 635.042, F.S.

Mortgage guaranty insurers would be permitted to exclude contingency reserves from total liabilities when demonstrating compliance with the minimum surplus required based on the percentage of total liabilities rather than the flat $4 million minimum. As under current law, the maximum required surplus would be $100 million.

Based on data available as of December 31, 1999, for the 22 companies writing mortgage guaranty insurance, the total required minimum surplus under current law was $673.7 million. By excluding contingency reserves from liabilities, the total required minimum surplus would be $338.6 million, a $335.1 million reduction in required minimum surplus. Examples of the effect the change has on two mortgage guaranty insurers are as follows:

	Company A	Company B
Total liabilities	$1.613 billion	$60.7 million
Less: Contingency reserve	$1.238 billion	$36.6 million
Minimum surplus: Current law	$100 million	$6 million
Minimum surplus: Bill	$37.5 million	$4 million
Change in minimum surplus	($62.5 million)	($2 million)

Mortgage guaranty insurers would be required to have sufficient capital and surplus so that the total outstanding aggregate exposure, *rather than liability*, net of reinsurance under their written policies, would not exceed 25 times its paid capital, surplus, and contingency reserve combined. This change could operate to require additional surplus and capital to write the same amount of business. Further, mortgage guaranty insurers would be required to disclose their total aggregate exposure, net of reinsurance, in their audited financial report which is submitted to the Department of Insurance. Finally, it authorizes the Department of Insurance would be authorized to take administrative action against mortgage guaranty insurers that are not in compliance with these requirements.

D. SECTION-BY-SECTION ANALYSIS:

N/A

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

	FY 2000-01	FY 2001-02
Insurer's Commissioner's Regulatory Trust Fund	($108,000)	indeterminate

See Fiscal Comments section.

2. Expenditures:

N/A

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   County governments would see a reduction in the amount of revenues received from taxes paid as a part of total appointment fees. Counties receive $6 for each appointment. Assuming 2,000 fewer appointments, the fiscal impact would be a negative $12,000 in FY 2000-01.

   See Fiscal Comments section.

2. Expenditures:

   N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The provision allowing disclosures to take place 30 days after the effective date of the credit insurance policy, if the sales transaction is via telephone, could result in the consumer not having sufficient knowledge about the product purchased. However, consumers would have 30 days from the date the disclosures are received to rescind their coverage.

Companies that sell credit life or disability insurance and credit property insurance would benefit because they could sell credit insurance to consumers. Since licenses for branch offices would no longer be required, the amount of appointment fees owed would be reduced. According to the Department of Insurance, agents who currently have multiple credit licenses would be able to reduce their expenses by holding the single credit license created by this bill.

Additionally, companies offering credit insurance would not have to obtain fingerprints from their officers during the licensure process, if such entities are regulated by certain state or federal agencies.

Mortgage guaranty insurers would benefit because they could decrease their liabilities by the amount of their contingency reserve for the purpose of calculating their minimum surplus requirements.

D. FISCAL COMMENTS:

Currently, 2,505 entities and individuals are appointed by credit-based limited lines insurers to sell credit-based limited lines insurance products. An 80 percent reduction in the number of appointments would reduce revenues by $108,000 [2,000 x ($42 appointment fee + $12 state tax]. These appointments are renewed biennially, explaining the difference in fiscal impact from one year to the next. This figure also assumes all appointments would be renewed in FY 2000-01.

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

A. APPLICABILITY OF THE MANDATES PROVISION:

N/A

B. REDUCTION OF REVENUE RAISING AUTHORITY:

N/A

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

N/A

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

The Department of Insurance characterizes the changes to the limit on total liabilities for mortgage guaranty insurers from “liability” to “exposure” on page 6, lines 4-8, of the bill as “clarifying.”

The requirement that a licensed entity file the names and addresses of business locations on page 3, lines 24-30, of the bill is limited to the sale of credit insurance, even though the bill eliminates the license requirement as to all forms of credit-based insurance.

The express prohibition on the sale of credit property insurance by financial institutions would be repealed. This change would seem to necessitate some conforming revision to section 626.321(1)(g) dealing with credit property insurance.

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:	Staff Director:
Stephen Hogge	Stephen Hogge