

STORAGE NAME: s2304s1z.in
DATE: June 13, 2000

****AS PASSED BY THE LEGISLATURE****
CHAPTER #: 2000-168, Laws of Florida

**HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
FINAL ANALYSIS**

BILL #: CS/SB 2304

RELATING TO: Reinsurance Credit

SPONSOR(S): Banking and Insurance; Senator Holzendorf

TIED BILL(S):

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

- (1) BANKING AND INSURANCE YEAS 9 NAYS 0
 - (2)
 - (3)
 - (4)
 - (5)
-

I. SUMMARY:

Under Florida's credit-for-reinsurance law, Florida-authorized insurance companies buying reinsurance and ceding (i.e., transferring) premium to a reinsurer may receive credit on their financial and accounting statements for the amount ceded if the reinsurance is of a type approved or otherwise qualified pursuant to s. 624.610, F.S.

Current law would be revised under this bill to bring Florida's law into closer conformity to the National Association of Insurance Commissioners' Model Act on Credit for Reinsurance.

The bill would adopt accreditation as a method for recognizing a reinsurer as an "approved reinsurer," standardize trust fund language, update risk transfer requirements, restrict the ceding reinsurance requirement to domestic insurers, provide rule-making authority, and make technical changes to the law.

The changes would also generally reinforce state action to compel security from alien reinsurers and to enforce state requirements that the claims against insolvent alien insurers be valued and paid in accordance with state law.

CS/SB 2304 would also make changes to s. 215.555, F.S., relating to the Florida Hurricane Catastrophe Fund, to limit an insurer's reimbursement to their payout multiple and revise the definition of "covered policy."

This bill would have no fiscal impact on state or local government.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|---|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

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

B. PRESENT SITUATION:

Florida Hurricane Catastrophe Fund (Cat Fund)

The Legislature created the Florida Hurricane Catastrophe Fund (Cat Fund) in 1993 following Hurricane Andrew. The Cat Fund is a state trust fund administered by the State Board of Administration (SBA) that reimburses insurers for a portion of their hurricane losses. The Cat Fund reimburses insurers for either 45 percent, 75 percent, or 90 percent of each insurer's hurricane losses in any one year, as selected by the insurer, above the insurer's retention.

In 1999, the Legislature amended s. 215.555, F.S., to limit the claims-paying capacity of the Cat Fund in any one year to \$11 billion. Any funds that remain in the Cat Fund after all claims are paid are used to pay for losses in a subsequent season (Chapter 99-217, L.O.F.). The amended statute provides that an insurer's reimbursement is only limited to that insurer's payout multiple only if the SBA determines that it will not be able to raise sufficient funds to pay all insurers in full.¹ This limitation should apply, whether or not the Cat Fund has sufficient funds to pay all insurers in full. For example, if a hurricane required the Cat Fund to pay out less than its claims-paying capacity, an insurer could recover more than its proportionate share of total Cat Fund premiums.

The definition of "covered policy" for the purposes of the Cat Fund excludes any "reinsurance agreement." Under the standard agreement used by the Residential Property Casualty Joint Underwriting Association (RPCJUA) and take-out companies, the take-out insurer agrees to assume the liability of the RPCJUA policy for the remainder of the policy term and then offer coverage on its own forms upon renewal. The current rules of the SBA recognize that the Cat Fund may provide coverage for an insurer removing covered policies from the RPCJUA on an assumption basis, under certain conditions.

Credit for Reinsurance

A Florida-authorized insurance company buying reinsurance and ceding (i.e., transferring) premiums to a reinsurer may receive credit on its financial and accounting statements for the amount ceded. An insurance company may receive this credit only if the reinsurer is

¹The payout multiple is calculated as the total capacity of the Cat Fund divided by the Cat Fund's annual aggregate premium.

approved or otherwise qualified pursuant to s. 624.610, F.S. An approved reinsurer must meet one of four different standards set forth in statute. An otherwise qualified or “nonapproved” reinsurer can qualify under one of four provisions.

The Florida credit-for-reinsurance law incorporates some, but not all, of the provisions of the National Association of Insurance Commissioners (NAIC) Model Law on Credit for Reinsurance. As the result of amendments to the Florida law over time, terminology is inconsistent and some cross-references are incorrect.

Currently, Florida law recognizes four types of “approved reinsurers”:

- 1) an insurer authorized to transact reinsurance in Florida;
- 2) an insurer approved by the Department of Insurance (DOI) meeting the same criteria for solvency established for authorized insurers;
- 3) an underwriting member of an insurance exchange domiciled in the U.S. that was licensed and in operation on or before January 1, 1993, provided that the exchange meets the financial requirements for an authorized insurer; or
- 4) a group of individual, unincorporated, or incorporated alien insurers which maintains funds of at least \$50 million held in trust for U.S. policyholders in a bank or trust company subject to supervision by any state or the U.S. or that is a member of the Federal Reserve System. The group must annually file evidence with the DOI that it can meet its obligations under its reinsurance agreements (the “Lloyd’s of London provision”).²

Under Florida law, insurers may take credit in their accounting and financial statements for reinsurance ceded to a “nonapproved reinsurer” if the reinsurer qualifies under any one of the following four provisions:

- 1) a reinsurer that maintains the standards and meets the financial requirements applicable to an authorized insurer;
- 2) a reinsurer that deposits funds pursuant to express provision in the reinsurance contract with a market value equal to the credit taken, as security for the payment of the obligations under the agreement;³

² The statute applies additional requirements for the trust agreements that are referred to in section 624.610 (3)(a)4. and (3)(b)2. If the trust fund is less than the amount required by the DOI or if the grantor of the trust has been declared insolvent, the reinsurer must agree to comply with orders of the commissioner with regulatory oversight or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner all of the assets of U.S. trust beneficiaries. Other related requirements apply.

³ The statute applies additional requirements for the trust agreements that are referred to in sections 624.610 (3)(a)4. and (3)(b)2. If the trust fund is less than the amount required by the DOI or if the grantor of the trust has been declared insolvent, the reinsurer must agree to comply with orders of the commissioner with regulatory oversight or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner all of the assets of U.S. trust beneficiaries. Other related requirements apply.

- 3) a clean, unconditional, evergreen⁴, and irrevocable letter of credit issued for at least a one-year term that equals or exceeds the liability of the reinsurer for a specific reinsurance agreement for the unearned premiums, outstanding losses, and an adequate reserve for incurred but not reported losses; or
- 4) when the reinsurance is ceded to a reinsurer that maintains a trust fund in a bank or trust company that is subject to supervision by any state or that is a member of the Federal Reserve System, for the payment of the valid claims for its U.S. business.

The DOI has broad authority to “disallow any credit which it finds would be contrary to the proper interests of the policyholders or stockholders of a ceding domestic insurer.”

For credit to be allowed, the reinsurance must be payable without diminution because of insolvency of the ceding insurer, except when the reinsurance contract specifically provides payment to the named insured, assignee, or named beneficiary, or the reinsurer (assuming insurer) has directly assumed the policy obligations of the ceding insurer.

Authorized Florida insurers must file with the DOI a copy of a summary statement regarding each reinsurance “treaty” (contract).

The DOI may disallow any credit if a ceding direct insurer increases its surplus as a result of payment of consideration to an assuming reinsurer for underwriting any loss obligation already incurred in excess of the consideration paid; or where the consideration paid is derived from present value or discounting concepts based upon anticipated investment income.

If the DOI finds that a reinsurance agreement creates a substantial risk of insolvency to either insurer, the DOI may by order require a cancellation of the reinsurance agreement.

No credit is allowed for reinsurance that does not create a meaningful transfer of risk of loss to the reinsurer, pursuant to DOI rules that must substantially conform with the 1991 NAIC Practices and Procedures Manual(s).

C. EFFECT OF PROPOSED CHANGES:

Florida Hurricane Catastrophe Fund

CS/SB 2304 would revise the current provision that limits each insurer’s reimbursement to the insurer’s payout multiple. As revised, the limitation would apply whether or not the Cat Fund has reached its claims-paying capacity of \$11 billion.

The definition of “covered policy” for purposes of Cat Fund coverage would also be amended. CS/SB 2304 would specify that covered policies include policies removed from the RPCJUA or the FWUA by an authorized insurer under the terms and conditions of an executed assumption agreement between the insurer and either association. This change would clarify that such assumption agreements are not considered reinsurance and are eligible for Cat Fund coverage. This would conform to the current rules and practices of the Cat Fund and the current interpretation of the DOI.

⁴ “Evergreen” is something such as a contract “...that renews itself from year to year in lieu of notice by one of the parties to the contrary.” Black’s Law Dictionary, 6th ed. (1990)

Credit for Reinsurance

Section 624.610, Florida Statutes, which is Florida's credit-for-reinsurance law, would be brought into closer conformity to the NAIC Model Act on Credit for Reinsurance.

The bill would adopt accreditation as a method for recognizing a reinsurer as an "approved reinsurer," standardize trust fund language, update risk transfer requirements, restrict the ceding reinsurance requirement to domestic insurers, provide rule-making authority, and make technical changes to the law.

The bill also would simplify the approval process for reinsurers by incorporating the NAIC concept of "accredited reinsurer" into Florida law. An "accredited reinsurer" would be one that is licensed or authorized to transact insurance or reinsurance in at least one state. The accredited reinsurer would be required to submit to the jurisdiction of the state, submit to the state's authority to examine books and records; file copies of certain financial statements with the DOI; and maintain a surplus as regards policyholders of not less than \$20 million.

This bill would reinforce actions taken to compel security from alien reinsurers and enforce state requirements that the claims against insolvent alien reinsurers be valued and paid in accordance with state law.

The law governing the reinsurance trust funds of Lloyd's of London would be conformed to the actual operation of the New York trusts as restructured by agreement between the New York Insurance Department and Lloyd's of London in 1995.

Uniform trust fund language would be created for the three classes of trust authorized in the NAIC model act. The regulatory authority would be made consistent with regard to these three classes of trusts.

D. SECTION-BY-SECTION ANALYSIS:

This section need be completed only in the discretion of the Committee.

III. 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

2. Expenditures:

None

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Insurers and reinsurers should benefit by conforming Florida's credit-for-reinsurance laws more closely to the NAIC Model Act and to the laws of most other states. The types of reinsurance transactions that would be permitted would be less likely to be subject to unique requirements in the state and would, therefore, reduce costs to insurers to ensure credit on their financial statements.

Insurers and their policyholders should benefit by provisions that strengthen the state's authority to compel security from alien reinsurers and to enforce state requirements that the claims against insolvent alien insurers be valued and paid in accordance with state law.

D. FISCAL COMMENTS:

None

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

A. APPLICABILITY OF THE MANDATES PROVISION:

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

B. REDUCTION OF REVENUE RAISING AUTHORITY:

The bill does not reduce the authority that municipalities or counties have to raise revenue in the aggregate.

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

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

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

STORAGE NAME: s2304s1z.in

DATE: June 13, 2000

PAGE 7

B. RULE-MAKING AUTHORITY:

CS/SB 2304 provides the DOI with specific rule-making authority to implement the provisions of this bill. These rules would be required to be in compliance with certain NAIC model regulations and manuals.

C. OTHER COMMENTS:

None

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:

Staff Director:

Meredith Woodrum Snowden

Stephen Hogge

FINAL ANALYSIS PREPARED BY THE COMMITTEE ON INSURANCE:

Prepared by:

Staff Director:

Meredith Woodrum Snowden

Stephen Hogge