# 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 2304

SPONSOR: Banking and Insurance Committee and Senator Holzendorf

SUBJECT: Reinsurance

DATE: March 21, 2000 REVISED:

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|---|---|---|---|---|
| 1. | Deffenbaugh | Deffenbaugh | BI | Favorable/CS |
| 2. | | | | |
| 3. | | | | |
| 4. | | | | |
| 5. | | | | |

## I. Summary:

CS/SB 2304 revises s. 215.555, F.S., related to the Florida Hurricane Catastrophe Fund and s. 624.610, F.S., related to credit for reinsurance.

The following changes are made to the Florida Hurricane Catastrophe Fund ("Fund"): (1) The bill corrects an error in the changes that were enacted in 1999 to the method for determining each insurer's recovery from the Fund. Last year's law was intended to limit each insurer's maximum recovery, in any one year, to its proportionate share of Fund premiums for that year, multiplied by the Fund's claims-paying capacity. However, the language provides that this limitation applies if the Fund determines that it will not be able to raise sufficient funds to pay all insurers in full. The bill specifies that this limitation on each insurer's recovery applies in all cases, even if sufficient funds are available to pay all insurers in full. (2) The bill clarifies that the Fund may provide coverage to insurers assuming liabilities for policies in the Florida Windstorm Underwriting Association or the Florida Windstorm Underwriting Association. This clarifies that such coverage is not contrary to the current law's provision that excludes from the definition of "covered policy" any "reinsurance agreement."

The bill also revises s. 624.610, F.S., relating to the types of reinsurance that are approved and reinsurers "accredited" in order for an insurer to obtain credit as an asset or a deduction from liability on its accounting and financial statements. These changes bring the Florida statute into closer conformity with the current National Association of Insurance Commissioners Model Act on Credit for Reinsurance.

The changes create uniform trust fund language for the three classes of trusts authorized and make consistent the regulatory authority with regard to these trusts. The changes 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. It also conforms state law governing Lloyd's of London reinsurance trust funds to the actual

operation of the New York trusts as restructured by agreement between the New York Insurance Department and Lloyds in 1995.

This bill substantially amends the following sections of the Florida Statutes: 215.555 and 624.610.

## II. Present Situation:

**Florida Hurricane Catastrophe Fund (Section 1)**

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

In 1999, amendments were enacted to s. 215.555, F.S. limiting reimbursement to insurers from the Cat Fund. (Chapter 99-217, L.O.F.; CS/CS/SB 1790). One change limited each insurer's reimbursement to the insurer's share of the total Cat Fund premiums paid for that year, multiplied by the actual claims-paying capacity available for that year ("payout multiple"). The amended statute provides that this limitation applies if the SBA determines that it will not be able to raise sufficient funds to pay all insurers in full. [s. 215.555(4)(d), F.S.] However, it was the apparent legislative intent that this limitation apply, *whether or not* the Fund has sufficient funds to pay all insurers in full. (See the 1999 Senate staff analysis to CS/CS/SB 1790.) For example, if a hurricane required the Fund to pay out less than its claims-paying capacity, an insurer could recover more than its proportionate share of total Cat Fund premiums, up to its selected percentage (45%, 75%, or 90%) of hurricane losses above its retention, as the statute currently reads. This result is contrary to the apparent legislative intent in 1999, which was to preserve reinsurance capacity of the Fund for subsequent storms by limiting each insurer's recovery to its payout multiple, among other changes. It was also recognized that when estimating potential reimbursement from the Cat Fund and structuring private reinsurance around Cat Fund coverage, insurers would use their payout multiple and would not obtain credit or savings from reinsurers (that could be passed on to policyholders) for any amounts in excess of the payout multiple, even though a greater recovery was theoretically possible.

A second Cat Fund issue addressed by this bill is the definition of " covered policy" for purposes of Cat Fund coverage, which currently excludes any "reinsurance agreement." [s. 215.555(2)(c), F.S.] That is, the Cat Fund provides coverage only for direct business of an insurer, not for policies reinsured by a reinsurer. It has been questioned whether this provision prevents the Cat Fund from providing coverage to an insurer when it assumes liability for policies taken out of the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) or the Florida Windstorm Underwriting Association (FWUA). These are the two state-created residual market insurers that provide property insurance coverage to persons unable to obtain coverage in the voluntary market. The RPCJUA, in particular, has entered into agreements with many insurers to take policies out of the RPCJUA, pursuant to an express legislative goal for "depopulation," which include financial incentives to take-out insurers. (See, ss. 627.351(6) and 627.3511, F.S.) Under the standard agreement used by the RPCJUA and take-out companies, the take-out insurer will agree 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 question is whether coverage by the take-out insurer during the period of assumption is considered “reinsurance” and, as such, ineligible for Cat Fund coverage. In response to a letter from the Cat Fund, the Department of Insurance determined that the premiums may be considered to be direct premiums of the takeout company for purposes of Cat Fund coverage, under certain conditions. (Letter from Wayne Johnson to Joan Lazar, 11/10/99.) The current rules of the State Board of Administration also recognize that the Cat Fund may provide coverage for an insurer removing covered policies from the RPCJUA on an assumption basis, under certain conditions. (19-8.028, F.A.C.)

**Credit for Reinsurance (Section 2)**

Insurance companies authorized in Florida that buy reinsurance are allowed to receive credit on their financial statements only if the reinsurance is a type that is approved or acceptable, as specified in s. 624.610, F.S. For example, an insurer is limited by state law as to the amount of premiums it may write as a percentage of its surplus (“premium to surplus ratio”). By buying reinsurance and *ceding* premiums to an approved reinsurer, the insurance company may obtain credit on its financial statements and deduct the ceded premiums from its net premium to surplus limitations. The insurer buying the reinsurance is referred to as the *ceding insurer* and the reinsurer is referred to as the *assuming insurer*.

Florida’s credit for reinsurance statute, s. 624.610, F.S., (1998 Supp.) has been subject to various amendments, most often to apply certain provisions of the National Association of Insurance Commissioners (NAIC) Model Law on Credit for Reinsurance as it has been amended from time to time. However, the piecemeal approach to amending the law has resulted in inconsistent terminology and incorrect cross-references and does not incorporate all of the substantive provisions of the model law.

Currently, the statute lists four types of “approved reinsurers” in paragraph (3)(a), which include:

1) an insurer authorized in Florida to transact such line of insurance or reinsurance;

2) an insurer approved by the Department of Insurance that meets 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) the Lloyd’s of London provision that refers to 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 and which annually files evidence with the department that it can meet its obligations under its reinsurance agreements. (See additional trust requirements below.*)

In addition to the types of “approved” reinsurers listed above, paragraph (3)(b) allows insurers to take credit in their financial statements for reinsurance ceded to a “nonapproved reinsurer” if it satisfies any of the following categories:

1) a reinsurer that maintains the standards and meets the financial requirements applicable to an authorized insurer;

2) a reinsurer that deposits funds for a specific reinsurance agreement with a market value equal to the credit taken, pursuant to express provision in the reinsurance contract, as security for the payment of the obligations under the agreement, if such funds are subject to withdrawal by, and under the control of, the ceding insurer or such deposits are placed in trust for such purposes in a bank which is a member of the Federal Reserve System if withdrawals from the trust cannot be made without the consent of the ceding insurer. (See additional trust requirements below.*);

3) a clean, unconditional, evergreen, 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. The letter must be issued by a banking institution which is a member of the Federal Reserve System and which has financial standing satisfactory to the department. The department may adopt rules requiring that the letter adhere to the format approved by the NAIC; 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 trust must have an amount not less than the reinsurer’s liabilities for its U.S. business and, in addition, a surplus of not less than $20 million. The trust must be in a form approved by the insurance commissioner where the trust is domiciled or the insurance commissioner of another state who, pursuant to the terms of the trust agreement, has accepted principal regulatory oversight. The reinsurer must report quarterly to the insurance commissioner information required to be reported on the NAIC Annual Statement form, and the trust and reinsurer must be subject to examination by the commissioner.

*The statute applies additional requirements for the trust agreements that are referred to in subparagraphs (3)(a)4. and (3)(b)2. If the trust fund is less than the amount required by the department 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.

Subsection (1) sets out the purpose of this section, which includes legislative intent and a requirement that upon the insolvency of a non-U.S. insurer or reinsurer which provides security to fund its U.S. obligations, the security must be maintained in the U.S. and claims must be filed with and valued by the State Insurance Commissioner with regulatory oversight, and the assets distributed in accordance with the insurance laws of the state in which the trust is domiciled. The Legislature declares that these matters are fundamental to the business of insurance. Such findings and requirements are intended to assert jurisdiction over such an insolvency to the maximum legal extent to prevent a federal bankruptcy court or foreign country from having jurisdiction and control over the assets.

A broad grant of authority is provided to the department to disallow any credit which it finds would be "contrary to the proper interests of the policyholders or stockholders of a ceding domestic insurer" (an insurer formed under the laws of Florida." [Subsection (5)]

If the department finds that a reinsurance agreement creates a substantial risk of insolvency to either insurer, the department may order cancellation of the reinsurance agreement. [Subsection (12)]

The department 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. [Subsection (11)]

No credit is allowed for reinsurance that does not create a meaningful transfer of risk of loss to the reinsurer, pursuant to department rules that must substantially conform with the 1991 NAIC Practices and Procedures Manual(s). [Subsection (13)]

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. [Subsection (7)]

Authorized Florida insurers are required to file with the department a copy of a summary statement regarding each reinsurance "treaty" (contract) within 30 days of receipt of a cover note or similar confirmation of coverage, but in no event later than 6 months after the effective date of the reinsurance treaty. The statute specifies the information that must be included in the summary statement and provides exceptions from this requirement. [Subsection (10)]

## III. Effect of Proposed Changes:

**Section 1. Florida Hurricane Catastrophe Fund**

The bill makes two changes to the Florida Hurricane Catastrophe Fund ("Cat Fund"), amending s. 215.555, F.S. First, the bill revises the current provision that limits each insurer's reimbursement to the insurer's share of the total Cat Fund premiums paid for that year, multiplied by the actual claims-paying capacity available for that year. The bill deletes the provision that this limitation applies if the SBA determines that it will not be able to raise sufficient funds to pay all insurers in full. As amended, this limitation would apply, *whether or not* the Fund has sufficient funds to pay all insurers in full. This conforms to the apparent legislative intent of amendments enacted in 1999, as explained in Present Situation, above.

The second change to the Cat Fund, is revising the definition of "covered policy" for purposes of Cat Fund coverage. The bill specifies that covered policies include policies removed from the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) or the Florida Windstorm Underwriting Association (FWUA) by an authorized insurer under the terms and conditions of an executed assumption agreement between the insurer and either association. Each assumption agreement must be approved by the department prior to the effective date of the assumption and the department must provide written notification to the board within 15 working days after such approval. This change clarifies that such assumption agreements are not considered "reinsurance" and, therefore, are not ineligible for Cat Fund coverage. This conforms to the current rules and practice of the Cat Fund and the current interpretation of the department, as summarized in Present Situation, above.

**Section 2. Credit for Reinsurance**

The bill substantially rewrites s. 624.610, F.S., primarily relating to the types of reinsurance that are approved and reinsurers "accredited" in order for an insurer to obtain credit as an asset or a deduction from liability on its accounting and financial statements. These changes bring the Florida statute into closer conformity with the NAIC Model Act on Credit for Reinsurance.

The bill, in subsection (1), retains the current law's purpose and intent provisions, related to the insolvency of a non-U.S. insurer or reinsurer which provides security to fund its U.S. obligations and that assets be distributed in accordance with the insurance laws of the state in which the trust is domiciled, which matters are fundamental to the business of insurance.

The bill provides that credit for reinsurance must be allowed a ceding insurer as either an asset or a deduction from liability only when the reinsurer meets the requirements of paragraphs (3)(a), (b), or (c), as set out below. For paragraphs (3)(a) and (b), the credit must be allowed only for those kinds of insurance that the assuming insurer is licensed, authorized, or otherwise permitted to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. The cited paragraphs refer to the following types of assuming reinsurers:

(a) An insurer that is authorized to transact insurance or reinsurance in Florida.

(b) An insurer that is "accredited" as a reinsurer in Florida, which must submit to the state's jurisdiction; submit to the state's authority to examine books and records; is licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, is entered through or licensed to transact insurance in at least one state; files copies of its annual and quarterly statements filed with the insurance department of its state of domicile and its most recent audited financial statement; and maintains a surplus of not less than $20 million.

    The insurer must have its accreditation approved by the department, or not denied within 90 days of its submission for approval. The provisions of s. 120.60, F.S., would not apply to the accreditation applications or procedures, which are the general license application procedures that apply to state agencies. The department may deny or revoke an assuming insurer's accreditation if the insurer does not submit the required documentation, fails to meet all of the required standards, or if the accreditation would be hazardous to the policyholders of the state. Factors are listed that the department may consider. The costs incurred by the department to review a reinsurer's request for accreditation must be charged to the requesting reinsurer.

(c) An insurer that maintains a trust fund in a qualified U.S. financial institution, as defined, for the payment of the valid claims of its U.S. ceding insurers. The insurer must report annually to the department information substantially the same as that required to be reported on the NAIC Annual Statement for by authorized insurers, and the insurer must submit to examination of its records and bear the expense of examination. The form of the trust must be approved by the commissioner of the state where the trust is domiciled or of another state who, pursuant to the trust agreement, has accepted principal regulatory oversight of the trust. The form of the trust and any amendments must be filed with the commissioner of every state in which the ceding insurer beneficiaries of the trust are domiciled, must provide that contested claims are valid and enforceable upon the final order of any court of competent jurisdiction in the U.S., and must vest legal title to its assets in its trustees for the benefit of the assuming insurer's U.S. ceding insurers. Each year the trustee must report to the commissioner in writing the balance of the trust.

The amount of funds required for the trust fund of an insurer qualifying under paragraph (c), above, depend upon the type of assuming insurer: 1) The trust fund for a single assuming insurer must consist of an amount not less that the insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers and, in addition, a trusteed surplus of not less than $20 million. 2) The trust fund for a group including incorporated and individual unincorporated underwriters must consist of an amount not less than the groups' several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group; however, for reinsurance agreements with an inception date on or before July 31, 1995, this amount must be not less than the group's several insurance and reinsurance liabilities attributable to business written in the U.S.; in both cases (before or after July 31, 1995) the group must additionally maintain in trust a surplus of $100 million held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account. The changes essentially conform the law governing Lloyd's of London reinsurance trust funds to the actual operation of the New York trusts as restructured by agreement between the New York Insurance Department and Lloyds in 1995.

The credit permitted by paragraph (c), above, must not be allowed unless the reinsurance agreement provides that assuming insurer agrees to submit to the jurisdiction of any court of competent jurisdiction if the insurer fails to perform its obligations under the terms of the agreement, and to designate the commissioner or a designated attorney to be served any lawful process on behalf of the ceding company. The assuming insurer must also agree to the following conditions: 1) if the trust fund is inadequate or if the grantor of the trust has been declared insolvent, the trustee must comply with an order of the commissioner with regulatory oversight or with an order of a U.S. court of competent jurisdiction directing the trustee to transfer to such commissioner all of the assets of the trust fund, to be distributed in accordance with the laws of the state in which the trust is domiciled; 2) if the commissioner with regulatory oversight determines that the assets of the trust are not necessary to satisfy the claims of the U.S. ceding insurer, the assets must be returned by the commissioner to the trustee for distribution in accordance with the trust agreement; and 3) the grantor must waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

Credit must be allowed when the reinsurance is ceded to an assuming insurer *not* meeting the requirements of paragraphs (a), (b), or (c), above but only as to the insurance of risks located in jurisdictions where the reinsurance is required to be purchased by a particular entity by applicable law. For example, Florida law itself has such a requirement, by requiring residential property insurers to purchase coverage (essentially, reinsurance) from the Florida Hurricane Catastrophe Fund.

An asset allowed or a deduction from liability taken for the reinsurance ceded by an insurer to an assuming insurer *not* meeting the requirements of subsections (2) and (3) (which are <u>all</u> of the types of approved reinsurance and accredited reinsurers discussed above), *is allowed* in an amount not exceeding the liabilities carried by the ceding insurer. The deduction must be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the U.S. subject to withdrawal solely by, and under the exclusive control of, the ceding insurer, or in the case of a trust, held in a qualified U.S. financial institution, as defined. This security may be in the form of cash; securities qualifying as admitted assets under the Insurance Code; clean, irrevocable, unconditional letters of credit issued by a qualified U.S. financial institution; or any other form of security acceptable to the department.

Two different definitions are provided for a "qualified U.S. financial institution" for two different purposes. The first definition applies for purposes of paragraph (4)(c) regarding issuing a letter of credit, discussed in the paragraph, above. This definition means an institution that is organized, or in the case of a U.S. office of a foreign banking organization, is licensed under the laws of the U.S. or any state; is regulated, supervised, and examined by U.S. or state authorities having regulatory authority over banks and trust companies; and has been determined by either the department or the Securities Valuation Office of the NAIC to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the department.

The other definition of "qualified U.S. financial institution" applies to the provisions which specify institutions that are eligible to act as a fiduciary of a trust. The definition is substantially the same as the first definition relating to licensure and regulatory supervision, but it does not include the requirement that the institution be determined by either the department or the Securities Valuation Office of the NAIC to meet certain standards of financial condition and standing.

The bill retains the current law provision that includes health maintenance organizations within the definition of ceding insurer.

Similar to current law, the bill authorizes the department to disallow any credit, after notice and an opportunity for a hearing, that it finds would be contrary to the proper interest of the policyholders or stockholders of a ceding domestic insurer.

The bill contains similar provisions to the current law that for credit to be allowed, the reinsurance must be payable without diminution because of insolvency of the ceding insurer, subject to certain exceptions.

The current law's requirements for authorized Florida insurers to file with the department a copy of a summary statement regarding each reinsurance "treaty" is limited by the bill to domestic insurers and commercially domiciled insurers. A "commercially domiciled insurer" is defined in s. 624.075, F.S., as a foreign or alien insurer that has written an average of 25 percent or more direct premiums in this state than it has written in its state of domicile during the preceding 3 years and the direct premiums written constitute more than 55 percent of its total direct premiums written in the U.S.

The bill retains the current law that authorizes the department to order cancellation of a reinsurance agreement if the department finds that the agreement creates a substantial risk of insolvency to either insurer. It also retains the current law that no credit is allowed for reinsurance that does not create a meaningful transfer of risk of loss to the reinsurer, but deletes the specific authority for the department to adopt rules in this regard (which currently must substantially conform with the 1991 NAIC Practices and Procedures Manuals).

The bill authorizes the department to adopt rules implementing the provisions of this section, which must be in substantial compliance with the NAIC model regulations relating to credit for reinsurance, the 1999 NAIC Accounting Practices and Procedures Manual.

Any reinsurer approved pursuant to the current version of s. 624.610(3)(a)2., F.S., which fails to obtain accreditation pursuant to this section prior to December 30, 2003, shall have its approval terminated by operation of law on that date.

This act applies to all cessions (reinsurance ceded) on or after January 1, 2001, under reinsurance agreements that have an inception, anniversary, or renewal date on or after January 1, 2001.

## 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:

Section 1. This section limits each insurer's reimbursement from the Florida Hurricane Catastrophe Fund to its share of the total Fund premiums, multiplied by the actual claims-paying capacity for that year ("payout multiple"), whether or not the Fund has sufficient funds to pay all insurers in full. This change will prevent an estimated 4 percent increase in Cat Fund premiums for the 2000 contract year under current law that would need to be charged to insurers (and passed on to policyholders), to actuarially account for those loss scenarios in which an insurer's losses exceed its payout multiple and the Fund would have sufficient funds to pay all insurers in full.

The changes to the Cat Fund clarifying that insurers may obtain Cat Fund coverage for policies assumed from the RPCJUA or FWUA will benefit such insurers, prevent possible litigation on this issue, and help encourage further depopulation of these associations.

Section 2. 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.

### C. Government Sector Impact:

See Private Sector, above, regarding the impact of the bill on revenues and expenses of the Florida Hurricane Catastrophe Fund.

## VI. Technical Deficiencies:

None.

## VII. Related Issues:

None.

## VIII. Amendments:

None.