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 822

SPONSOR: Banking and Insurance Committee and Senator Webster

SUBJECT: Premium Security Deposits

DATE: January 20, 2000 REVISED:

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

I. Summary:

The bill would expressly authorize insurers to accept and hold premium security deposits made by a policyholder under commercial property and casualty insurance contracts, including workers' compensation insurance contracts. Insurers holding a premium security deposit would also be authorized to pay interest to the policyholder on the premium security deposit.

For purposes of assessing the insurance premium tax under the provisions of s. 624.509, F.S., a premium security deposit would not be recognized as being received, and subject to taxation, until the deposit is used by the insurer to pay any earned premium obligation of the insured.

The committee substitute bill would also require a premium security deposit to be considered as an "unearned premium" under the provisions of chapter 631, F.S., in the event an insurer became insolvent. Unearned premiums are included within the definition of the class three (out of the ten classes) in the prioritization for the distribution of claims from an insolvent insurer's estate.

This bill creates section 627.4045, Florida Statutes.

II. Present Situation:

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. Currently, Florida law does not expressly prohibit or authorize the use of premium security deposits.

Premium security deposits are advance payments or monies pledged for the purpose of paying any additional premium owed an insurer. An insurer may require policyholders to pay or post a premium security deposit in instances where the total premium owed under the policy may not be known until a later date.

Under certain circumstances, premiums are subject to adjustment over the life of the policy or at the expiration of the policy. Adjustments may result from audits, endorsements, or retrospective ratings. Since workers' compensation premiums are usually based on payroll data and claims experience, premium billings to employers are generally estimated and are subject to a final audit, at which time the actual premium is calculated.

Under a retrospective plan, the actual premium payable by the insured is not determined until the end of the policy term. This retrospective premium, calculated based on the insured's actual loss experience, may differ considerably from the original, expected premium. For example, the estimated premium may be $1 million. However, under a retrospective 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.

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. However, if the advance premium and audit premium is less than the earned premium, the insured will owe additional premium. Due to the uncertainty of the final amount of premium, an insurer may require an insured to pay or post a premium security deposit to guarantee payment if additional premium is owed. This deposit could take the form of an actual cash deposit, certificate of deposit, bond, or a letter of credit issued by a financial institution.

Effective January 1, 2000, the Florida Workers' Compensation Joint Underwriting Association (FWCJUA) requires an insured to pay a " . . . deposit premium of 50 percent for all policies whose total estimated annual premiums are less than or equal to $10,000 . . . " According to the FWCJUA, "A deposit premium is required to secure or renew coverage. At final audit, the deposit shall be applied to any earned premium due . . ." The deposit amount is based on the total estimated annual premium.

Insurance Premium Tax

For purposes of assessing the insurance premium tax authorized under the provisions of s. 624.509, F.S., the premium tax is based on premiums *received* during the preceding calendar year. The amount of premiums received by a particular insurer is derived from the National Association of Insurance Commissioners annual statement insurers submit to the Department of Insurance.

Guaranty Funds and "Covered Claims"

Chapter 631, F.S., addresses insurer insolvency (rehabilitation and liquidation) and the guaranty of payment. The Legislature has created guaranty funds as mechanisms to provide for the prompt payment of covered claims in the event a member insurer becomes insolvent. The Florida Insurance Guaranty Association and the Florida Workers' Compensation Insurance Guaranty Association are established in parts II and V, ch. 631, F.S., respectively. *Covered claim* is defined to mean " . . . an unpaid claim, including one of *unearned premium*, which arises out of, and is within the coverage, and not in excess of, the applicable limits of an insurance policy . . . "

Section 631.271, F.S., establishes the priority of distribution of claims from an insolvent insurer's estate. Every claim in each class is required to be paid in full or adequate funds are required to be retained for such payment before members of the next class may receive any payment. The section defines classes 1 - 10 as the order of distribution, with class 1 receiving the highest priority in the distribution. Unearned premiums are included in the class 3 category.

According to the National Association of Insurance Commissioners Accounting Practices for Property and Casualty Manual, "The earned premium of an insurance policy represents the pro rata portion of the premiums in force applicable to the expired portion of the policy term, plus or minus the premiums earned on audits and other adjustments." To the extent a portion of the premium security deposit is considered an unearned premium, an insured would have a covered claim and be able to recover the unearned portion of the premium security deposit from the applicable guaranty fund.

III. Effect of Proposed Changes:

Section 1. Creates s. 627.4045, F.S., relating to premium security deposits, to expressly authorize an insurer to accept and hold premium security deposits. The term, "premium security deposit," is defined to mean moneys which are deposited with an insurer to secure payment of a premium under an insurance contract or agreement to provide commercial property and casualty lines coverage, including workers' compensation and employers' liability coverage. An insurer is authorized to pay interest to the insured.

For purposes of assessing the insurance premium tax under the provisions of s. 624.509, F.S., a premium security deposit would not be recognized as being received until the deposit is used by the insurer to pay any earned premium obligation of the insured.

In addition, the bill requires premium security deposits to be considered as "unearned premium" under the insurer insolvency and guaranty of payment provisions of chapter 631, F.S., in the event an insurer became insolvent. In the event of an insurer's insolvency, unearned premium is included within the definition of the class three (out of the ten classes) in the prioritization for the distribution of claims from an insolvent insurer's estate.

Section 2. Provides that the act shall take effect upon becoming a law.

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:

Property and casualty insureds (including workers' compensation insureds) could avoid the expense associated with securing a bond or letter of credit in order to satisfy any requirements to post a security deposit with an insurer.

Insurers would benefit from receiving deposits in advance and investing such funds. Also, insurers would be able to defer paying the insurance premium tax on unearned premiums, since they would not be liable for paying the insurance premium tax on the unearned premium portion of the security deposit until the premium was actually earned.

C. Government Sector Impact:

Since insurance premium tax on premium security deposits would not be assessed and due until the actual premium was earned (instead of when the premium was received), the recognition and collection of premium tax attributable to unearned premiums would be deferred.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.