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**HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS**

BILL #: CS/HB 1101
RELATING TO: Insurer rehabilitation and liquidation
SPONSOR(S): Committee on Insurance and Representative Gannon
TIED BILL(S):

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

- (1) INSURANCE YEAS 14 NAYS 0
- (2) JUDICIAL OVERSIGHT
- (3) READY INFRASTRUCTURE
- (4)
- (5)

I. SUMMARY:

When solvency protections fail, the Department of Insurance (Department) may seek to be appointed Receiver of an insurer through a judicial proceeding for the purpose of rehabilitating an impaired insurer or, if rehabilitation is unsuccessful or otherwise inappropriate, liquidating the insolvent company. State law is the "sole and exclusive method of liquidating, rehabilitating, reorganizing, or conserving an insurer." Three guaranty funds exist to pay claims of insolvent insurers to the extent the assets of the insolvent insurer are insufficient to do so or the terms of any takeover or purchase by another insurer do not provide for the assumption of this obligation.

Changes related to the insurer rehabilitation and liquidation process proposed in the proposed committee substitute would include:

- identifying those persons or entities subject to receivership proceedings and within the court's jurisdiction;
- providing for the tolling of statutes of limitations because of delinquency proceedings;
- specifying the authority of the Receiver to exercise the rights of policyholders, creditors, the estate, and the entity, or entities, in receivership;
- allowing the Receiver to recover costs expended in, rather than only those costs necessary to, the recovery of property, including the expenses and salary of "in-house" staff;
- permitting the Receiver to exercise plenary powers to investigate an insolvency prior to or during the pendency of a delinquency proceeding, rather than relying on the civil discovery process;
- allowing the Receiver, after appointment, to determine the information subject to discovery;
- creating a civil cause of action and criminal penalties against certain persons;
- providing for the closing of a liquidation proceeding and the disposition of assets that cannot be distributed in a cost-effective manner; and
- further specifying the Florida Insurance Guaranty Association's limitations on liability.

The proposed committee substitute could reduce state government expenditures and would take effect July 1, 2001.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

1. Less Government Yes No N/A

The proposed committee substitute would create new governmental authority and power when investigating or overseeing an insolvent insurer, create civil causes of action and criminal penalties for certain specified fraudulent acts.

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

B. PRESENT SITUATION:

The Department has a wide range of options when it determines through financial reports, examinations, or other sources that an insurer has failed any of the solvency tests or is otherwise in unsound financial condition. General powers include the following: suspending or revoking an insurer's certificate of authority; imposing administrative fines; issuing cease-and-desist orders; and removing, suspending, or restricting the activities of those individuals operating or directing the affairs of the insurer.

In addition to these general powers, the Department may place certain insurers of "unsound condition" under administrative supervision. These included domestic, commercially domiciled, and specialty insurers. Administrative supervision is an administrative proceeding in which the Department, with the consent of a financially troubled insurance company, supervises the management of the insurance company in an attempt to cure the company's troubles rather than close it down.

When solvency protections fail, the Department may seek to be appointed Receiver through a judicial proceeding for the purpose of rehabilitating an impaired insurer or, if rehabilitation is unsuccessful or otherwise inappropriate, liquidating the insolvent company. The goal of rehabilitation is to restore the financial solvency of the insurer. When the company is beyond rehabilitation, the Department acts to secure and maximize the assets of the insolvent company for the benefit of its policyholders through liquidation. Insurers are generally exempt from federal bankruptcy laws; state law is the "sole and exclusive method of liquidating, rehabilitating, reorganizing, or conserving an insurer."

The choice between rehabilitation and liquidation requires the Department to balance the prospects for restoring the insurer's financial stability against the size of the potential insolvency and impact on policyholders and other creditors. Delaying the liquidation of an insolvent insurer frequently can increase the size of the insolvency and increase the burden on the guaranty association created to pay claims under policies issued by an insolvent company. Rehabilitation enables the insurer to continue to participate in the market without burdening the applicable guaranty association.

Three guaranty funds exist to pay claims of insolvent insurers to the extent the assets of the insolvent insurer are insufficient to do so or the terms of any takeover or purchase by another insurer do not provide for the assumption of this obligation. The Florida Insurance Guaranty Association pays the claims of insolvent property and casualty insurers other than workers' compensation. The Florida Workers' Compensation Insurance Guaranty Association pays the claims of insolvent workers' compensation insurers other than individually self-insured employers, and the Florida Life and Health Insurance Guaranty Association pays the claims of life and health insurers, both subject to certain conditions and limitations.

The guaranty funds operate as non-profit corporations. They are not state agencies. As a condition of receiving a license to transact insurance in this state, insurers writing property and casualty insurance, workers' compensation, and life and health insurance are required to participate in the respective guaranty association. The Department appoints a board of governors for each association and approves their respective plans of operation. Payment of covered claims of insolvent insurers is funded by assessments against insurers, up to specified limits. Terms of the assessment authority vary among the three associations.

C. EFFECT OF PROPOSED CHANGES:

The proposed committee substitute would make changes addressing litigation of delinquency proceedings, investigation of impaired or insolvent insurers, prosecution of fraudulent activities, guaranty association liabilities, and certain other matters as follows:

Litigation

- provide additional statements of statutory purpose to support language proposed by the committee substitute, conform to federal law, and establish Florida as a "reciprocal state."
- apply the definition of "asset" to all of part I of ch. 631, F.S.
- define, for the purposes of part I of ch. 631, F.S.,
 - "bona fide holder for value."
 - "fair consideration."
 - "good faith."
 - "property."
- identify those subject to receivership proceedings and within the jurisdiction of the receivership court.
- provide for the tolling of statutes of limitations because of delinquency proceedings.
- specify the authority of the Receiver to exercise the rights of policyholders, creditors, the estate, and the entity, or entities, in receivership.
- allow the Receiver to recover costs expended in, rather than only those costs necessary to, the recovery of property, including the expenses and salary of "in-house" staff.

Investigation

- permit the Receiver to exercise plenary powers to investigate an insolvency prior to or during the pendency of a delinquency proceeding, rather than relying on the civil discovery process. These powers would include the authority to:
 - examine and review documents.
 - take testimony and depositions.
 - request subpoenas.
 - examine and review the books, records, and documents of specified persons.

- allow the Receiver, after appointment by the court, to determine the information subject to discovery.

Prosecution of fraud

- provide for a civil cause of action against certain persons for specified fraudulent acts.
- create criminal penalties for certain fraudulent activities.

Guaranty association

- specify that the Florida Insurance Guaranty Association is not liable for claims for contribution or indemnity by reinsurers, insurers, insurance pools, or underwriting associations.
- amend the limits of liability for the Florida Insurance Guaranty Association.

Other

- provide for the closing of a liquidation proceeding and the disposition of assets that cannot be distributed in a cost-effective manner.
- conform cross-references to changes proposed by the committee substitute.

The provisions of the proposed committee substitute would take effect on July 1, 2001.

D. SECTION-BY-SECTION ANALYSIS:

Section 1: Amends paragraph (w) of subsection (1) of s. 626.9541, F.S., to conform cross-references to changes proposed by the committee substitute.

Section 2: Amends s. 631.001, F.S., to provide a more comprehensive statement of the purposes of part I of ch. 631, F.S., the "Insurers Rehabilitation and Liquidation Act," to support the amendments and additions proposed by the proposed committee substitute. This section also would satisfy the requirements of the federal McCarran-Ferguson Act, which allows states to regulate the business of insurance, which otherwise would be preempted by federal law.

Section 3: Amends s. 631.011, F.S., to apply the definition of "assets" to all of part I of ch. 631, F.S., and create certain new statutory definitions. The proposed committee substitute would define, for purposes of part I of ch. 631, F.S., the terms "bona fide holder for value," "fair consideration," "good faith," and "property." According to the Department, the meanings of these terms are litigated repetitively.

Section 631.261(3), F.S., allows the Receiver to avoid transfers of property and liens. The Receiver may not recover transferred property from a "bona fide holder for value." Transferees of property defend the Receiver's recovery actions by claiming to be a "bona fide holder for value." This term is not defined in statute and must be applied on a case-by-case basis. "Bona fide holder for value" would be defined, for the purposes of part I of ch. 631, F.S., as a person who, unaware of the insurer's financial condition, or the receivership proceeding, exchanged funds, assets, or property, of equivalent value with the insurer. The Receiver would not be able to recover transferred property from a "bona fide holder for value," as defined by the proposed committee substitute.

Under s. 631.262, F.S., the Receiver may have any transfer made or obligation incurred within one year prior to a successful delinquency petition voided, if there was not "fair consideration" given. The Receiver may similarly void any transaction with a reinsurer if there is a want of "fair consideration." "Fair consideration" is not defined by statute. For the purposes of part I of ch. 631, "fair consideration" would be a value received by the insurer that is not less than the value given by the insurer. Essentially, there would be "fair consideration" given if the insurer is left in an equivalent or better condition as a result of the exchange.

Statute protects persons engaging in dealings in “good faith” with the insurer, both before and during the delinquency proceeding. However, “good faith” is not defined by statute.¹ “Good faith” would mean being honest in fact and intention while exercising reasonable business judgment. Persons who knew, or should have known, of the financial condition of the insurer or the receivership, would not be acting in good faith.

The value of an estate is determined in large part by the “property” of the estate. The statute does not define the term “property.” The proposed committee substitute would define “property” in broad terms and preserve entitlements that exist prior to a conservation, rehabilitation, or liquidation order or arise by operation statute. Privileged or confidential documents of an insurer, generated by a third party, would not be “property” of the insolvent.

Section 4: Creates s. 631.025, F.S., to identify who would be subject to receivership proceedings and who could be brought within the jurisdiction of the receivership court. Currently, there is no statutory provision identifying the persons or entities that may be subject to the exercise of the jurisdiction of the receivership court. Under this section, any person who is an insurer and any person, whether an insurer or not, who is necessary to the proceedings under part I of ch. 631, F.S., would be subject to the delinquency proceedings. This section also would specifically identify certain persons who, among others, may be subject to receivership proceedings and within the receivership court’s jurisdiction, including:

- present and past domestic insurers,
- persons acting as insurers,
- foreign insurers,
- persons organized or organizing to insure,
- current and former agents, brokers, officers, directors, manager, trustees, organizers, promoters, and persons in control of the insurer,
- policyholders
- excess insurers,
- reinsurers,
- third-party administrators,
- any person maintaining information for an insurer,
- corporations owning, directly or indirectly, 10 percent or more of the insurer, or
- any person or entity subject to part I of ch. 631, F.S.

Section 5: Amends paragraph (d) of subsection (1) of s. 631.041, F.S., to conform cross-references to changes proposed by the proposed committee substitute. Creates subsection (6) of s. 631.041, F.S., to provide that statutes of limitations, and the similar equitable defense of laches,² would be tolled during the pendency of a delinquency petition. The intricacies of a receivership estate are such that valuable rights may not be discovered by the Receiver until after expiration of the statute of limitations. Loss of these rights prevents the Receiver from maximizing the value of the receivership estate. If a delinquency petition were denied, the section would allow 60 days for filing of any action that could have been filed during the pendency of the petition.

¹ While the statute does not define “good faith,” it does identify one situation where a person is not acting in good faith. As to persons who engage in a transfer of property or asset from an impaired or insolvent insurer after the filing of a delinquency petition, those persons with actual knowledge of the delinquency proceeding are deemed not to be acting in good faith. This means that, rather than the Receiver having to prove bad faith, the transferee has to prove good faith. The burden of proof has shifted by operation of statute.

² Courts of equity limit the time that a claimant has to assert a claim through the doctrine of laches. This doctrine denies relief to a claimant who has unreasonably delayed or been negligent in pursuing a claim, when that delay or negligence is prejudicial to the party subject to the claim. Black’s Law Dictionary, Seventh Edition (1999).

Section 6: Creates s. 631.113, F.S., to provide that unexpired statutes of limitations would be tolled, for up to 4 years, from the date of entry of an order placing the control of the insurer in the hands of an administrator, conservator, rehabilitator, receiver, liquidator, or similar official or agency. Since a delinquency proceeding is complicated and may take years to complete, the Receiver might not discover and exercise its rights as Receiver until after the expiration of applicable statutes of limitations, thus limiting the value of the estate.

This section would also limit the accrual of, and running of limitations on, actions arising while persons in control of the insurer are acting contrary to the insurer's interests or when the relevant facts are fraudulently concealed. Courts would be directed to interpret the provisions of ch. 95, F.S., Florida's general statute of limitations provision, consistent with this section of the proposed committee substitute. The tolling of statutes of limitations proposed by this section would not be cumulative to other tolling provisions. The Receiver would have at least 180 days from the entry of the order to perform any other act that is subject to a fixed time period.

Section 7: Renumbers subsections (6) – (9) and creates a new subsection (6) of s. 631.141, F.S. In defense of recovery actions, persons holding property or assets that the Receiver seeks to return to the estate will assert that the Receiver lacks standing to enforce the rights of others. The Receiver must repetitively litigate whether the Receiver has standing to pursue recovery actions. This section would specify that, when conducting delinquency proceedings against domestic and alien insurers, the Receiver would have the authority to exercise the rights of policyholders, creditors, the estate, and the entity or entities in receivership if the exercise of those rights would benefit the estate or claimants.

Section 8: Amends paragraph (d) of subsection (6) of s. 631.154, F.S. Currently, the Receiver may recover costs "necessary to" the recovery of funds and property of the estate from third parties. Rather than recovering just the costs "necessary to" the recovery, this section would allow the Receiver to recover costs "expended in" the recovery action. While the Receiver maintains an in-house staff, out-side counsel is often employed to litigate various issues. The costs associated with in-house staff are not necessarily recovered. This section would also specifically allow the Receiver to recover the costs associated with in-house staff.

Section 9: Creates s. 631.156, F.S. During a delinquency proceeding, the Receiver currently conducts investigations into the reasons for the insolvency of an insurer. There is no specific statutory authority for such an investigation; rather, it is conducted through the civil court discovery process or through the Receiver's powers as receiver. This section would allow the Receiver to conduct an investigation, prior to a delinquency proceeding, into the insolvency of an insurer, the location of assets, the recovery of assets, the filing of false statements with the Department, and the violation of any insurer solvency laws. The Receiver would be required to conduct the investigation if a delinquency petition is granted.

The Receiver would be given the authority to:

- examine and review documents,
- take statements and depositions, and
- request subpoenas.

The Receiver also would have the authority to examine and review the books, records, and documents of any;

- affiliate,
- controlling person,
- officer,

- director,
- manager,
- trustee,
- agent,
- adjuster,
- employee,
- independent contractor of any insurer or affiliate, and
- any other person who has exercised or possessed executive authority over the affairs of the insurer or affiliate.

The Department would be permitted to share investigatory information with the Department's Division of Insurance Fraud and other state and federal agencies without waiving any privilege to prevent disclosure.

Currently, the receivership court determines the information the Department may have access to through the discovery process. Under this section of the proposed committee substitute, the Department, after being appointed Receiver, would be granted the authority to determine what books, records, documents, or testimony will further the investigation. A party disputing the Department's access to information would be required to prove to the receivership court that the Department's actions are an abuse of its discretion. Parties withholding requested evidence from the Department would be subject to being held in contempt of court.

Section 10: Creates s. 631.157, F.S., to create a civil cause of action by the Receiver. The Receiver would be authorized to pursue a civil action against certain persons within 4 years of the initial order of rehabilitation or liquidation or the close of the action, whichever is earlier.

Any person who willfully steals property or assets of an insurer would be liable for:

- the full value of the asset or property, if the action did not jeopardize the insurer or was not a significant cause of the insolvency, or
- triple the value of the asset or property, if the action jeopardized the insurer or was significant cause of the insolvency.

Any person who knew, or should have known, of the financial condition of the insurer and knowingly made a false statement of material fact, with the intent to deceive, would be liable for:

- the full value of the misreported asset, if the misreport did not jeopardize the insurer or was not a significant cause of the insolvency, or
- triple the value or the misreported asset, if the misreport jeopardized the insurer or was a significant cause of the insolvency.

Section 11: Amends s. 631.193, F.S., to provide that the filing of a claim with the Receiver does not create an additional liability on a guaranty association. The guaranty association's liability would be the same as if a claim had not been filed with the Receiver.

Section 12: Creates s. 631.3995, F.S., to provide for closing the estate in a liquidation proceeding and pouring over any assets, that cannot be distributed in a cost-effective manner, to the Closed Estate Trust Fund, if created by law. The Closed Estate Trust Fund would be used to fund receivership actions where the assets of the insolvent are insufficient to support the administration of the estate or the insolvent. The receivership court would be authorized to reopen the estate, upon a showing of good cause.

Section 13: Amends subsection (3) of s. 631.54, F.S. The definition of "covered claim," for the purposes of the Florida Insurance Guaranty Association Act, would be amended specifically to

exclude claims for contribution or indemnification by reinsurers, insurers, insurance pools, or underwriting associations.

Section 14: Amends subsection (1) of s. 631.57, F.S., to further limit the liability of the Florida Insurance Guaranty Association. In addition to the current limits on the Association's liability, the Association would not be obligated to pay a claim in those instances where the insurer would not have been compelled to pay the claim. The Association would be specifically granted the same defenses to a claim that the insurer would have enjoyed. The Association's liabilities on a claim would be cross-referenced to the amounts set forth in ch. 631, F.S.

Section 15: Amends subsection (1) of s. 631.60, F.S., to expressly limit a claimant's causes of action and rights against the Florida Insurance Guaranty Association to those causes of action and rights that would have been available against the insurer.

Section 16: Creates s. 817.2341, F.S., to create criminal penalties for certain violations. A person would be guilty of a third degree felony upon:

- making a false entry of a material fact in any book, report, or statement with the intent to deceive any person about the financial condition of the insurer,
- knowingly making a material false statement to the Department, or
- knowingly and materially overvaluing any property reported to the Department.

A person would be guilty of a first degree felony upon:

- making a false entry of material fact with the intent to deceive any person about the impairment of the insurer's capital,
- making a false entry of material fact that is the significant cause of the delinquency proceeding,
- knowingly making a false statement to the Department with the intent to deceive any person about the impairment of the insurer's capital, or
- knowingly making a false statement to the Department that is the significant cause of the delinquency proceeding.

Section 17: Provides that the proposed committee substitute would take effect on July 1, 2001.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

N/A

2. Expenditures:

See fiscal comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

N/A

2. Expenditures:

N/A

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Unknown.

D. FISCAL COMMENTS:

The proposed committee substitute may decrease state government expenditures by allowing the Receiver to recover the cost expended in recovering property of the insolvent estate, including "in-house" staff salaries and expenses, rather than just those expenses necessary to the recovery of property.

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

A. APPLICABILITY OF THE MANDATES PROVISION:

This proposed committee substitute does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This proposed committee substitute does not reduce the authority that counties or municipalities have to raise revenues in the aggregate.

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

This proposed committee substitute does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

N/A

B. RULE-MAKING AUTHORITY:

N/A

C. OTHER COMMENTS:

N/A

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

The proposed committee substitute would differ from the original bill in that the proposed committee substitute would:

- delete provisions referencing "single business enterprise";
- provide a narrower statement of purpose;
- remove proposed language from the definitions section;

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- rewrite the proposed definition of "property";
- provide alternative jurisdictional language;
- deletes proposed language prohibiting insurers and the insurer's affiliates from withholding from the Department of Insurance any books, records, documents, or testimony that would be privileged had there been no affiliation;
- eliminate proposed language providing for recovery of damages and costs for willful violations of the automatic stay provided under statute; and
- further specify the Florida Insurance Guaranty Association's limitation of liability.

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:

Staff Director:

Eric Lloyd

Stephen T. Hogge