SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 1816

SPONSOR: Banking and Insurance Committee and Senator Klein

SUBJECT: Insurer Rehabilitation and Liquidation

DATE: April 24, 2001 REVISED: _____ _____ _____ _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Emrich	Deffenbaugh	BI	Favorable/CS
2.			AGG	
3.			AP	
4.				
5.				
6.				

I. Summary:

Under current law, the Department of Insurance has specified procedures when it determines through financial reports, examinations, or other sources that an insurance company has failed certain solvency tests or is otherwise in unsound financial condition. The department may place certain insurers of "unsound condition" under administrative supervision. Such supervision allows the department, with the consent of a financially troubled insurance company, to supervise the management of the insurance company in an attempt to cure the company's troubles rather than close it down.

However, when solvency protections fail, the Department of Insurance may seek to be appointed as the receiver of an insurance company 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 provides for the "sole and exclusive method of liquidating, rehabilitating, reorganizing, or conserving an insurer" under Part I of ch. 631, F.S.

Committee Substitute for Senate Bill 1816 proposes changes to the insurer rehabilitation and liquidation process to provide for the following:

- expands the authority of the Department of Insurance, as Receiver, to exercise the rights of policyholders, creditors, the estate, and the entity, or entities, in receivership;
- clarifies key provisions in the law to provide guidance to courts during rehabilitation and liquidation proceedings;
- identifies those persons or entities subject to receivership proceedings and who are within the court's jurisdiction;
- tolls and extends the statute of limitations as to specified proceedings;
- allows the Receiver to recover costs expended in the recovery of property, including the expenses and salary of personnel;

- permits the Receiver to exercise plenary powers to investigate an insolvency prior to liquidation, rather than relying on the civil discovery process;
- creates a civil cause of action by the Receiver, and provides for specified amounts for damages;
- creates criminal penalties as to persons who make materially false statements or reports to the Department of Insurance as to the financial condition of the insolvent insurer;
- provides for the closing of a liquidation proceeding; and
- specifies that the Florida Insurance Guaranty Association assumes all defenses available to the insolvent insurer.

This bill substantially amends the following sections of the Florida Statutes: 631.001, 631.011, 631.041, 631.141, 631.154, 631.157, and 631.54. The bill creates the following sections of the Florida Statutes: 631.025, 631.113, 631.156, 631.157, 631.3995, and 817.2341.

II. Present Situation:

Rehabilitation and Liquidation Proceedings

The Department of Insurance has specified procedures when it determines through financial reports, examinations, or other sources that an insurance company has failed any of the solvency tests or is otherwise in unsound financial condition. The department may place certain insurers of "unsound condition" under administrative supervision (s. 624.80-91, F.S.). These include 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.

However, when solvency protections fail, the department may seek to be appointed as 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 (s. 631.001-631.399, F.S.). 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.[1] 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 particular 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.

[1] Insolvency is defined to mean that all the assets of the insurer, if made immediately available, would not be sufficient to discharge all of its liabilities or that the insurer is unable to pay its debts as they become due in the usual course of business. Insolvency also includes "impairment of surplus, and "impairment of capital (s. 631.011(11), F.S.

Under current law, there are three guaranty funds which were created 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 (s. 631.50-70, F.S.). The Florida Workers' Compensation Insurance Guaranty Association pays the claims of insolvent workers' compensation insurers other than individually self-insured employers (s. 631.901-932, F.S.), and the Florida Life and Health Insurance Guaranty Association pays the claims of life and health insurers (s. 631.711-631.737, F.S.), 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.

Criminal Penalties

Under present law, it is a third degree penalty for any person to willfully file with the Department of Insurance, or who willfully signs for filing with the department, a materially false or materially misleading financial statement or document, with the intent to deceive and knowing that such statement is materially false or materially misleading. A third degree penalty provides for up to 5 years incarceration and a $5,000 fine.

According to representative with the department, the present criminal penalty provisions do not contemplate the various fraudulent financial practices utilized by persons who may cause some insurers to become insolvent. For example, such persons may make, for financial gain, material misrepresentations to insurers, who in good faith, utilize these representations as the basis for financial decisions in operating an insurance company. When such a company becomes insolvent, according to department officials, it is necessary to have criminal provisions which are tailored to such sophisticated financial fraud.

III. Effect of Proposed Changes:

Section 1. Amends s. 626.9541, F.S., relating to the unfair trade practices act, to provide a correct cross-reference as to impairment of capital or surplus.

Section 2. Amends s. 631.001, F.S., to provide a comprehensive statement of the purposes of part I of ch. 631, F.S., the "Insurers Rehabilitation and Liquidation Act," to provide guidance to the courts in interpreting the law. In general, the intent language provides that the purpose of the Act is to protect the interests of the insureds, claimants, creditors and the public by providing a comprehensive scheme for receivership of insurers; establish Florida as a reciprocal state in those states which enact the National Assn. of Insurance Commissioners Rehabilitation and Liquidation Model Act or the Uniform Insurers Liquidation Act; make more efficient the administration of insurer receiverships and improve the methods for rehabilitating insurers;

enhance the efficiency and economy of liquidation through clarification of the law; establish a system that equitably apportions any loss; and maximize recovery of assets. Provides that this part shall be liberally construed to affect the noted purposes of the act and authorizes the department in its capacity as rehabilitator or receiver to pursue actions for damages or other recoveries on behalf of the insurer and its policyholders, creditors, and estate. Provides that this part may be cited as the "Insurers Rehabilitation and Liquidation Act."

Section 3. Amends s. 631.011, F.S., the definition section, to provide that the term *assets* shall mean only those assets defined in chapter 625. Section 625.012, F.S., defines assets according to numerous criteria under the Insurance Code to include cash, investments, interest, dividends, rent, taxes, and premium notes. The bill creates new statutory definitions for the terms *bona fide holder for value, fair consideration, good faith, liabilities, and property.* According to the department, the meanings of these terms are litigated repeatedly.

The term *bona fide holder for value* means a holder who, while not having information that would lead a reasonable person in the holder's position to believe that the insurer is financially impaired, has, using reasonable business judgment, exchanged his or her funds, for funds of the insurer which have an equivalent market value. *Fair consideration* means consideration that is given for property or assets of the insurer when, in exchange for the property, and in good faith, property is conveyed, services rendered, having a value to the insurer of not less than the value of the property given in exchange. *Good faith* as applied to a transferree or transferor, means being honest in fact and intention while exercising reasonable business judgment. The term *liabilities* contains a correct cross-reference.

The value of an estate is determined in large part by the *property* of the estate. The term *property* is defined as, in broad terms, with respect to an insolvent entity, to include all right and title and interest of the insolvent entity. It also includes all records and date that are otherwise the property of the insolvent insurer.

Section 4. Creates s. 631.025, F.S., to identify those persons 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, such persons include: any person who is transacting or has transacted insurance business in or from this state and against whom claims arising from that business exist or may exist in the future; any person who purports to transact an insurance business in this state, with or without a certificate of authority; an insurer who has insureds residing in this state; and all other persons organized with the intent to transact an insurance business in this state.

Section 5. Amends s. 631.041, F.S., relating to automatic stays. Creates subsection (6) of s. 631.041, F.S., to provide that statutes of limitations, and the similar equitable defense of laches, would be tolled between the filing of a petition for conservation, rehabilitation, or liquidation against an insurer and the order granting or denying that petition. If a delinquency petition were denied, any action against the insurer that might have been commenced when the petition was filed may be commenced for at least 60 days after the order denying such relief.

Section 6. Creates s. 631.113, F.S., to provide for the tolling of the statute of limitations for claims brought by the Receiver. This provision would give the Receiver four 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. Specifically, it provides that the running of any unexpired statute of limitations as to any claims brought by such administrator seeking damages or other recoveries on behalf of an insurer, its policyholders, or its estate, shall be tolled for 4 years from the entry of an order placing such administrator over the insurer, provided, if the delinquency proceedings terminate in less than 4 years, such tolling shall cease at the time the proceedings are concluded.

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. Often the Receiver does not know of all the possible claims, e.g., contracts that are voidable or asset transfers that may constitute preferences, until its appointment and until it is able to devote time and personnel to a full investigation of the insurer's affairs. If the statute of limitations continues to run on these claims during the time that it may take to perform the investigation, many claims may be lost.

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. The tolling of statute of limitations would be cumulative to other tolling provisions. The Receiver would have at least 180 days from the entry of the order of rehabilitation or liquidation to perform any other act that is subject to a fixed time period.

Section 7. Amends s. 631.141, F.S. involving conduct of delinquency proceedings, to specify the Receiver's legal standing to bring claims on behalf of the policyholders, creditors, and estate.

Section 8. Amends s. 631.154 (6)(d), F.S., relating to funds in the possession of third persons, to provide that the Receiver be entitled to recover judgment for costs which include in-house staff and staff attorney's expenses, costs, and salaries, expended in the recovery of the property. 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, outside counsel is often employed to litigate various issues. The costs associated with in-house staff are not necessarily recovered. This section would specifically allow the Receiver to recover the costs associated with in-house staff.

Section 9. Creates s. 631.156, F.S., pertaining to investigations by the Department of Insurance. 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 bill would allow the Receiver to conduct an investigation, *prior* to instituting a delinquency proceeding, which would greatly benefit the Receiver. The

Receiver would be able to investigate the insolvency of an insurer, examine and review documents, take statements and depositions, and request subpoenas.

For example, the Receiver 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, to the extent such examination is calculated to disclose the reasons for such insolvency, discovery of assets and whether the law has been violated. In its capacity as Receiver, 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 work product privilege to prevent disclosure.

A party disputing the department's access to information would be required to present such contention by written motion to the receivership court within 20 days after receipt of the request and shall be responsible for the loss of any evidence which occurs after the department first informs said party of its request. Such court must determine whether the department has abused its discretion in seeking such evidence or testimony. Parties withholding requested evidence from the department, after unsuccessfully asserting such objection, 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 cause of action against specified persons within 4 years after the entry of the initial order of rehabilitation or liquidation, but such cause must be filed before the time the receivership proceeding is closed or dismissed. It provides that any person who is engaged in the business of insurance or who acts as an officer, or agent of any person engaged in such insurance in a transaction of such business and who willfully obtains or uses any asset or property of an insurer, shall be liable to the department as receiver for the use and benefit of an insolvent insurer's estate, creditors, and policyholders, as follows:

- if such obtaining or using did not jeopardize the safety and soundness of an insurer and was not a significant cause of such insurer being placed in conservation, rehabilitation, or liquidation, such person shall be liable only for the full amount of any asset obtained or used, plus prejudgment interest provided by law;
- if such obtaining or using jeopardized the safety and soundness of an insurer or was a significant cause of such insurer's being placed in such liquidation, such person is liable for triple the full amount of any asset obtained or used, plus prejudgment interest provided by law on the original amount.

Any person engaged in the business of insurance who knew, or should have known, of the financial condition of the insurer and knowingly made a false statement of a material fact in any report or statement, with the intent to deceive such insurer, the department, or any agent appointed by the department, shall be liable to the department as receiver for the use and benefit of the insolvent insurer's estate, creditors, and policyholders, as follows:

- if such misreporting did not jeopardize the safety and soundness of an insurer and was not a significant cause of such insurer's being placed in such liquidation, such person is liable only for the full amount of any asset misreported, or

- if such misreporting jeopardized the safety and soundness of an insurer or was a significant cause of such insurer's being placed in such liquidation, such person is liable for triple the full amount of any asset misreported.

If the Receiver is successful in establishing a claim, the Receiver is entitled to costs, investigative expenses, salaries of the department's in-house staff and attorney's fees.

Section 11. Amends s. 631.57, F.S., relating to the powers of the Florida Insurance Guaranty Association (FIGA), to provide that FIGA may be deemed to have the defenses of the insolvent insurer as if the insurer had not become insolvent.

Section 12. Creates s. 631.3995 F.S., relating to the closing of the estate. It provides that when all assets have been distributed, the department may petition the court to terminate the liquidation proceedings and close the estate. Any remaining assets that may not be distributed to claimants shall be deposited into a segregated account to be known as the Closed Estate Fund Trust Account, if created by law. The department may use moneys held in such account for paying administrative expenses of companies subject to this provision. The receivership court would be authorized to reopen the estate, upon a showing of good cause, by the department.

Section 13. Amends s. 631.54 (3), 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. Creates s. 817.2341, F.S., to create criminal penalties affecting persons engaged in the administration of any insurer or entity organized under chapter 624 (insurers) or chapter 641 (health maintenance organizations (HMOs). 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/HMO,
- 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 or HMOs 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 or HMOs capital, or
- knowingly making a false statement to the department that is the significant cause of the delinquency proceeding.

Section 15. Provides that the bill would take effect on July 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:

Policyholders of insolvent insurers would benefit because the bill allows the Department of Insurance, as Receiver, to establish efficient asset collection procedures so as to provide more capital to fund policyholder's claims.

C. Government Sector Impact:

The provisions of the bill will benefit the Department of Insurance in its receivership actions. Also, the bill may decrease state government expenditures by allowing the Department of Insurance, as 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.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.