

By Representative Clarke

1 A bill to be entitled
2 An act relating to investment of assets by
3 insurers; amending s. 625.012, F.S.; including
4 certain derivative instruments as assets of an
5 insurer; amending s. 625.305, F.S.; revising
6 limitations on certain investments eligible for
7 diversification; amending s. 625.324, F.S.;
8 expanding eligible corporate stocks authorized
9 for investment by insurers; creating ss.
10 625.341 and 641.2255, F.S.; providing for
11 financial derivative instruments for certain
12 insurers and organizations; specifying
13 requirements; requiring certain systems for
14 certain purposes; providing requirements for an
15 insurer's board of directors; requiring
16 insurers to maintain certain documentation;
17 providing requirements for derivative
18 instruments; amending s. 641.35, F.S.;
19 specifying certain derivative instruments as
20 assets of a health maintenance organization;
21 providing an exception to an exclusion of
22 certain assets for certain purposes; providing
23 for investment of health maintenance
24 organization funds in certain corporate stocks
25 under certain circumstances; providing a
26 limitation; providing for investment of health
27 maintenance organization funds in excess of
28 certain reserves or surplus under certain
29 circumstances; providing a limitation;
30 providing for retroactive operation; providing
31 an effective date.

1 Be It Enacted by the Legislature of the State of Florida:

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3 Section 1. Subsection (16) of section 625.012, Florida
4 Statutes, is renumbered as subsection (17) and a new
5 subsection (16) is added to said section to read:

6 625.012 "Assets" defined.--In any determination of the
7 financial condition of an insurer, there shall be allowed as
8 "assets" only such assets as are owned by the insurer and
9 which consist of:

10 (16) Derivative instruments used for hedging, income
11 enhancement, or replication of other investment instruments,
12 provided the derivative instruments are not contributing to
13 financial leverage or speculation. For purposes of this
14 chapter, "hedging" means investment in an asset to reduce
15 overall risk, "income enhancement" means use of an existing
16 asset to modestly increase return without increasing risk, and
17 "replication" means combining two or more assets to duplicate
18 the characteristics of the desired asset.

19 Section 2. Paragraph (a) of subsection (2) of section
20 625.305, Florida Statutes, is amended to read:

21 625.305 Diversification.--

22 (2) Investments eligible under subsection (1), except
23 investments acquired pursuant to s. 625.331, are subject to
24 the following limitations:

25 (a) The cost of investments made by insurers in stock
26 authorized by s. 625.324 shall not exceed 30 ~~15~~ percent of the
27 insurer's admitted assets; the cost of such investment in
28 common stocks shall not exceed 20 ~~10~~ percent of the insurer's
29 admitted assets; and the cost of such investment in stock of
30 any one corporation, excluding diversified investment
31 companies or common trust funds, shall not exceed 3 percent of

1 the insurer's admitted assets. Notwithstanding any other
2 provision in this chapter, the cost basis or market value, if
3 lower, of all stock investment shall be used for the purpose
4 of determining the asset value against which such percentage
5 limitations are to be applied.

6 Section 3. Section 625.324, Florida Statutes, is
7 amended to read:

8 625.324 Corporate stocks.--An insurer may invest in
9 stocks, common or preferred, of any corporation created or
10 existing under the laws of the United States or of any state
11 or Canada or any province thereof. An insurer may invest in
12 stocks, common or preferred, of any corporation created or
13 existing under the laws of any foreign country other than
14 Canada if such stocks are listed and traded on a national
15 securities exchange in the United States, listed or traded on
16 foreign securities exchanges, traded in foreign
17 over-the-counter markets subject to a governing authority
18 authorized for such purposes in the foreign country, or, in
19 the alternative, if such investment in stocks of any
20 corporation created or existing under the laws of any foreign
21 country are first approved by the department. Nothing in this
22 section shall apply to qualifying investments made by an
23 insurer in a foreign country under authority of s. 625.326.

24 Section 4. Section 625.341, Florida Statutes, is
25 created to read:

26 625.341 Financial derivative instruments.--An insurer
27 may invest any of its funds in options, warrants, or futures,
28 as defined in the National Association of Insurance
29 Commissioners Derivative Instruments Model Regulation adopted
30 in October 1997, subject to the following requirements:
31

1 (1) A derivative transaction is an investment by an
2 insurer in a derivative instrument and is limited to options,
3 warrants, or futures.

4 (2) Before engaging in a derivative transaction, an
5 insurer shall establish written guidelines that shall be used
6 for effecting and maintaining the transactions. The guidelines
7 shall:

8 (a) Address investment or, if applicable, underwriting
9 objectives and risk constraints, such as credit risk limits.

10 (b) Address permissible transactions and the
11 relationship of those transactions to its operations, such as
12 a precise identification of the risks being hedged by a
13 derivative transaction.

14 (c) Require compliance with internal control
15 procedures.

16 (3) An insurer shall have a system for determining
17 whether a derivative instrument used for hedging has been
18 effective.

19 (4) An insurer shall have a credit risk management
20 system for over-the-counter derivative transactions that
21 measures credit risk exposure using the counterparty exposure
22 amount. A counterpart is a business entity other than an
23 exchange or clearinghouse.

24 (5) An insurer's board of directors shall, in
25 accordance with relevant state regulations:

26 (a) Approve the guidelines required by subsection (1)
27 and the systems required by subsections (2) and (3).

28 (b) Determine whether the insurer has adequate
29 professional personnel, technical expertise, and systems to
30 implement investment practices involving derivative
31 instruments.

1 (6) An insurer shall maintain the following
2 documentation and records relating to each derivative
3 transaction:

4 (a) The purposes of the transactions.

5 (b) The assets or liabilities to which the transaction
6 relates.

7 (c) The specific derivative instrument used in the
8 transaction.

9 (d) For over-the-counter derivative transactions, the
10 name of the counterparty and the counterparty exposure amount.

11 (e) For exchange traded derivative instruments, the
12 name of the exchange and the name of the firm that handled the
13 trade.

14 (7) Each derivative instrument shall be:

15 (a) Traded on a qualified exchange;

16 (b) Entered into with, or guaranteed by, a business;

17 (c) Issued or written by or entered into with the
18 issuer of the underlying interest on which the derivative
19 instrument is based; or

20 (d) Entered into with a qualified foreign exchange.

21 Section 5. Section 641.2255, Florida Statutes, is
22 created to read:

23 641.2255 Financial derivative instruments.--An
24 organization may invest any of its funds in options, warrants,
25 and futures, as defined in the National Association of
26 Insurance Commissioners Derivative Instruments Model
27 Regulation adopted in October 1997, subject to the following
28 requirements:

29 (1) A derivative transaction is an investment by an
30 organization in a derivative instrument and is limited to
31 options, warrants, or futures.

1 (2) Before engaging in a derivative transaction, an
2 organization shall establish written guidelines that shall be
3 used for effecting and maintaining the transactions. The
4 guidelines shall:
5 (a) Address investment or, if applicable, underwriting
6 objectives and risk constraints, such as credit risk limits.
7 (b) Address permissible transactions and the
8 relationship of those transactions to its operations, such as
9 a precise identification of the risks being hedged by a
10 derivative transaction.
11 (c) Require compliance with internal control
12 procedures.
13 (3) An organization shall have a system for
14 determining whether a derivative instrument used for hedging
15 has been effective.
16 (4) An organization shall have a credit risk
17 management system for over-the-counter derivative transactions
18 that measures credit risk exposure using the counterparty
19 exposure amount. A counterpart is a business entity other than
20 an exchange or clearinghouse.
21 (5) An organization's board of directors shall, in
22 accordance with relevant state regulations:
23 (a) Approve the guidelines required by subsection (1)
24 and the systems required by subsections (2) and (3).
25 (b) Determine whether the organization has adequate
26 professional personnel, technical expertise, and systems to
27 implement investment practices involving derivative
28 instruments.
29 (6) An organization shall maintain the following
30 documentation and records relating to each derivative
31 transaction:

- 1 (a) The purposes of the transactions.
2 (b) The assets or liabilities to which the transaction
3 relates.
4 (c) The specific derivative instrument used in the
5 transaction.
6 (d) For over-the-counter derivative transactions, the
7 name of the counterparty and the counterparty exposure amount.
8 (e) For exchange traded derivative instruments, the
9 name of the exchange and the name of the firm that handled the
10 trade.
11 (7) Each derivative instrument shall be:
12 (a) Traded on a qualified exchange;
13 (b) Entered into with, or guaranteed by, a business;
14 (c) Issued or written by or entered into with the
15 issuer of the underlying interest on which the derivative
16 instrument is based; or
17 (d) Entered into with a qualified foreign exchange.
18 Section 6. Subsection (1), paragraph (b) of subsection
19 (2), and subsections (14) and (15) of section 641.35, Florida
20 Statutes, are amended, to read:
21 641.35 Assets, liabilities, and investments.--
22 (1) ASSETS.--In any determination of the financial
23 condition of a health maintenance organization, there shall be
24 allowed as "assets" only those assets that are owned by the
25 health maintenance organization and that consist of:
26 (a) Cash or cash equivalents in the possession of the
27 health maintenance organization, or in transit under its
28 control, including the true balance of any deposit in a
29 solvent bank, savings and loan association, or trust company
30 which is domiciled in the United States. Cash equivalents are
31 short-term, highly liquid investments, with original

1 maturities of 3 months or less, which are both readily
2 convertible to known amounts of cash and so near their
3 maturity that they present insignificant risk of changes in
4 value because of changes in interest rates.

5 (b) Investments, securities, properties, and loans
6 acquired or held in accordance with this part, and in
7 connection therewith the following items:

8 1. Interest due or accrued on any bond or evidence of
9 indebtedness which is not in default and which is not valued
10 on a basis including accrued interest.

11 2. Declared and unpaid dividends on stock and shares,
12 unless the amount of the dividends has otherwise been allowed
13 as an asset.

14 3. Interest due or accrued upon a collateral loan
15 which is not in default in an amount not to exceed 1 year's
16 interest thereon.

17 4. Interest due or accrued on deposits or certificates
18 of deposit in solvent banks, savings and loan associations,
19 and trust companies domiciled in the United States, and
20 interest due or accrued on other assets, if such interest is
21 in the judgment of the department a collectible asset.

22 5. Interest due or accrued on current mortgage loans,
23 in an amount not exceeding in any event the amount, if any, of
24 the excess of the value of the property less delinquent taxes
25 thereon over the unpaid principal; but in no event shall
26 interest accrued for a period in excess of 90 days be allowed
27 as an asset.

28 (c) Premiums in the course of collection, not more
29 than 3 months past due, less commissions payable thereon. The
30 foregoing limitation shall not apply to premiums payable
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1 directly or indirectly by any governmental body in the United
2 States or by any of their instrumentalities.

3 (d) The full amount of reinsurance recoverable from a
4 solvent reinsurer, which reinsurance is authorized under s.
5 624.610.

6 (e) Pharmaceutical and medical supply inventories.

7 (f) Goodwill created by acquisitions and mergers
8 occurring on or after January 1, 2001.

9 (g) Loans or advances by a health maintenance
10 organization to its parent or principal owner if approved by
11 the department.

12 (h) Derivative instruments used for hedging, income
13 enhancement, or replication of other investment instruments,
14 provided the derivative instruments are not contributing to
15 financial leverage or speculation. For purposes of this
16 chapter, "hedging" means investment in an asset to reduce
17 overall risk, "income enhancement" means use of an existing
18 asset to modestly increase return without increasing risk, and
19 "replication" means combining two or more assets to duplicate
20 the characteristics of the desired asset.

21 (i)~~(h)~~ Other assets, not inconsistent with the
22 provisions of this section, deemed by the department to be
23 available for the payment of losses and claims, at values to
24 be determined by it.

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26 The department, upon determining that a health maintenance
27 organization's asset has not been evaluated according to
28 applicable law or that it does not qualify as an asset, shall
29 require the health maintenance organization to properly
30 reevaluate the asset or replace the asset with an asset
31 suitable to the department within 30 days of receipt of

1 written notification by the department of this determination,
2 if the removal of the asset from the organization's assets
3 would impair the organization's solvency.

4 (2) ASSETS NOT ALLOWED.--In addition to assets
5 impliedly excluded by the provisions of subsection (1), the
6 following assets expressly shall not be allowed as assets in
7 any determination of the financial condition of a health
8 maintenance organization:

9 (b) Any note or account receivable from or advances to
10 officers, directors, or controlling stockholders, whether
11 secured or not, and advances to employees, agents, or other
12 persons on personal security only, other than those
13 transactions authorized under paragraph (1)(g), unless such
14 note or account receivable is payable by the controlling
15 stockholder or entity to the health maintenance organization
16 and is secured by assets that are allowable as admitted assets
17 under this section.

18 (14) SPECIAL LIMITATION INVESTMENTS.--

19 (a) After satisfying the requirements of this part,
20 any funds of the health maintenance organization may be
21 invested in the following investments, subject to a cost
22 limitation of 10 percent of its admitted assets in each
23 category of investment:

24 1. Anticipation obligations of political subdivisions
25 of a state.--Anticipation obligations of any political
26 subdivision of any state of the United States, including, but
27 not limited to, bond anticipation notes, tax anticipation
28 notes, preliminary loan anticipation notes, revenue
29 anticipation notes, and construction anticipation notes, for
30 the payment of money within 12 months from the issuance of the
31 obligation, on the following conditions:

- 1 a. The anticipation notes are a direct obligation of
2 the issuer under conditions set forth in subsection (9).
- 3 b. The political subdivision is not in default in the
4 payment of the principal or interest on any of its direct
5 general obligations or any obligation guaranteed by such
6 political subdivision.
- 7 c. The anticipated funds are specifically pledged to
8 secure the obligations.
- 9 2. Revenue obligations of state or municipal public
10 utilities.--Obligations of any state of the United States, a
11 political subdivision thereof, or a public instrumentality of
12 any one or more of the foregoing for the payment of money, on
13 the following conditions:
- 14 a. The obligations are payable from revenues or
15 earnings of a public utility of such state, political
16 subdivision, or public instrumentality which are specifically
17 pledged therefor.
- 18 b. The law under which the obligations are issued
19 requires that such rates for service shall be charged and
20 collected at all times so as to produce sufficient revenue or
21 earning, together with any other revenues or moneys pledged,
22 to pay all operating and maintenance charges of the public
23 utility and all principal and interest on such charges.
- 24 c. No prior or parity obligations payable from the
25 revenues or earnings of that public utility are in default at
26 the date of such investment.
- 27 3. Other revenue obligations.--Obligations of any
28 state of the United States, a political subdivision thereof,
29 or a public instrumentality of any of the foregoing for the
30 payment of money, on the following conditions:
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1 a. The obligations are payable from revenues or
2 earnings, excluding revenues or earnings from public
3 utilities, specifically pledged therefor by such state,
4 political subdivision, or public instrumentality.

5 b. No prior or parity obligation of the same issuer
6 payable from revenues or earnings from the same source has
7 been in default as to principal or interest during the 5 years
8 next preceding the date of the investment, but the issuer need
9 not have been in existence for that period, and obligations
10 acquired under this paragraph may be newly issued.

11 ~~4. Corporate stocks.--Stocks, common or preferred, of~~
12 ~~any corporation created or existing under the laws of the~~
13 ~~United States or any state thereof. The organization may~~
14 ~~invest in stocks, common or preferred, of any corporation~~
15 ~~created or existing under the laws of any foreign country if~~
16 ~~such stocks are listed and traded on a national securities~~
17 ~~exchange in the United States or, in the alternative, if such~~
18 ~~investment in stocks of any corporation created or existing~~
19 ~~under the laws of any foreign country are first approved by~~
20 ~~the department. Investment in common stock of any one~~
21 ~~corporation shall not exceed 3 percent of the health~~
22 ~~maintenance organization's admitted assets.~~

23 (b) After satisfying the requirements of this part,
24 any funds of the health maintenance organization may be
25 invested, subject to a cost limitation of 20 percent of its
26 admitted assets, in stocks, common or preferred, of any
27 corporation created or existing under the laws of the United
28 States or any state thereof. The organization may invest in
29 stocks, common or preferred, of any corporation created or
30 existing under the laws of any foreign country if such stocks
31 are listed and traded on a national securities exchange in the

1 United States, listed and traded on foreign securities
2 exchanges, or traded in foreign over-the-counter markets
3 subject to a governing authority authorized for such purposes
4 in the foreign country, or, in the alternative, if such
5 investment in stocks of any corporation created or existing
6 under the laws of any foreign country are first approved by
7 the department. Investment in common stock of any one
8 corporation, excluding diversified investment companies or
9 common trust funds, shall not exceed 3 percent of the health
10 maintenance organization's admitted assets.

11 (c)~~(b)~~ After satisfying the requirements of this part,
12 the health maintenance organization may invest its funds and
13 accumulations in the following investments, subject to a cost
14 limitation of 5 percent of admitted assets in each category of
15 investment:

16 1. Obligations of the International Bank for
17 Reconstruction and Development.--Obligations issued or
18 guaranteed by the International Bank for Reconstruction and
19 Development.

20 2. Obligations of the Inter-American Development
21 Bank.--Obligations issued or guaranteed by the Inter-American
22 Development Bank.

23 3. Obligations of the Asian Development
24 Bank.--Obligations issued or guaranteed by the Asian
25 Development Bank.

26 4. Obligations of the State of Israel.--Direct
27 obligations of the State of Israel for the payment of money,
28 or obligations for the payment of money which are guaranteed
29 as to the payment of principal and interest by the State of
30 Israel, on the condition that the State of Israel shall not be
31 in default in the payment of principal or interest on any of

1 its direct, general obligations on the date of such
2 investment.

3 5. Obligations of the African Development
4 Bank.--Obligations issued or guaranteed by the African
5 Development Bank.

6 6. Obligations of the Government of Canada or any
7 province thereof.--Obligations issued or guaranteed by the
8 Government of Canada or any province thereof.

9 7. Obligations of the International Finance
10 Corporation.--Obligations issued or guaranteed by the
11 International Finance Corporation.

12 (15) ~~SPECIAL CONSENT INVESTMENT OF EXCESS FUNDS~~.--
13 (a) After satisfying the requirements of this part,
14 any funds of a health maintenance organization in excess of
15 its statutorily required reserves and surplus may be invested:

16 1. Without limitation in any investments otherwise
17 authorized by this part; or

18 2. In such other investments not specifically
19 authorized by this part provided such investments do not
20 exceed the lesser 5 percent of the health maintenance
21 organization's admitted assets or 25 percent of the amount by
22 which a health maintenance organization's surplus exceeds its
23 statutorily required minimum surplus. A health maintenance
24 organization may exceed the limitations of this subparagraph
25 only with the prior written approval of the department.

26 (b) Nothing in this section authorizes a health
27 maintenance organization to:

28 1. Invest any funds in excess of the amount by which
29 its actual surplus exceeds its statutorily required minimum
30 surplus; or
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1 2. Make any investment prohibited by this code ~~Any~~
2 ~~investment of the health maintenance organization's funds not~~
3 ~~enumerated in this part requires the prior approval of the~~
4 ~~department.~~

5 Section 7. This act shall take effect upon becoming a
6 law and shall operate retroactively to January 1, 2002.

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9 HOUSE SUMMARY

10 Includes derivative instruments used for hedging, income
11 enhancement, or replication of other investment
12 instruments as assets of an insurer or health maintenance
13 organization. Revises limitations on investments eligible
14 for diversification by insurers and health maintenance
15 organizations. Expands eligible corporate stocks
16 authorized for investment by insurers and health
17 maintenance organizations. Authorizing investment in
18 financial derivative instruments by insurers and health
19 maintenance organizations and specifies requirements. See
20 bill for details.
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