

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.)

Prepared By: Banking and Insurance Committee

BILL: SB 1590

SPONSOR: Senator Garcia

SUBJECT: Joint Underwriter and Reinsurers/Workers' Compensation

DATE: March 20, 2005

REVISED: 03/22/05

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Fav/2 amendments</u>
2.	<u></u>	<u></u>	<u>GE</u>	<u></u>
3.	<u></u>	<u></u>	<u>GA</u>	<u></u>
4.	<u></u>	<u></u>	<u></u>	<u></u>
5.	<u></u>	<u></u>	<u></u>	<u></u>
6.	<u></u>	<u></u>	<u></u>	<u></u>

Please see last section for Summary of Amendments

- Technical amendments were recommended
- Amendments were recommended
- Significant amendments were recommended

I. Summary:

Summary: Senate Bill 1590 provides the following changes to laws governing the Florida Workers' Compensation Joint Underwriting Association, the insurer of last resort, to provide greater accountability and oversight of the administration of the JUA and the regulation of rates:

Board Membership and Oversight

- Expands board membership from nine to 11 members by increasing the number of appointees by the Financial Services Commission (FSC) from three to five members and authorizes the FSC to remove any member for cause. The insurance industry would continue to appoint 5 members, state government would now appoint 6 members (5 by the FSC and 1 by the Consumer Advocate for the Department of Financial Services);
- Requires that the headquarters of the JUA be established and maintained in Tallahassee;
- Subjects meetings to ch. 286, which requires open meetings for governmental entities, unless otherwise provided; and
- Requires the JUA to return any state funds in excess of the amount necessary to fund deficits.

Cost-Effective Administration of the JUA

- Requires the JUA to provide services in the most cost-effective and efficient manner that includes the use of competitive selection of service providers; and
- Requires the JUA to provide reasonable notice to potential service carrier providers via advertisements in the Florida Administrative Weekly, trade journals, or major Florida newspapers.

Regulation of Rates

- Subjects the JUA to the same rate regulation that applies to workers' compensation insurers in the voluntary market. Currently, the JUA files its rates with the Office of Insurance Regulation (OIR) and immediately uses the new rates. The burden is on the OIR to prove that the rates are inadequate or excessive. Insurers in the voluntary market are required to obtain prior approval of their rates prior to using the new rates.

This bill substantially amends the following section of the Florida Statutes: 627.311.

II. Present Situation:

The Florida Workers' Compensation Joint Underwriting Association

The JUA's governing board is comprised of nine members, consisting of three members appointed by the Financial Services Commission (FSC); two members representing the top 20 domestic insurers writing workers' compensation in Florida; two members representing the top 20 foreign insurers writing workers' compensation in Florida; one person appointed by the largest property and casualty insurance agents' association in Florida; and the consumer advocate for the Department of Financial Services.

The JUA is authorized to establish and use its rates and rating plans at any time, but no more than two times per calendar year for any rating class. This is commonly referred to as "use and file." This method of rate regulation allows the JUA to file its rates and immediately begin using the new rates. If the OIR subsequently determines that the rates are excessive, the JUA would be required to refund the excess premium collected. In contrast, the OIR must approve rate filings for workers' compensation insurers in the voluntary market before the rates become effective.¹ Florida law requires every workers' compensation insurer to file with the Office of Insurance Regulation (OIR) its rates and classifications which the insurer proposes to use.² The standard for approving insurance rates in Florida is that the rate may not be excessive, inadequate, or unfairly discriminatory.³

During the last two Legislative sessions, the Legislature has addressed concerns regarding affordability and availability of workers' compensation insurance for small employers in the Florida Workers' Compensation Joint Underwriting Association, the insurer of last resort. In

¹ Section 627.101(2), F.S.

² Section 627.091(1), F.S. All insurance rate regulation is within the jurisdiction of the Office of Insurance Regulation, headed by a director appointed by the Financial Services Commission, composed of the Governor and Cabinet.

³ Sections 627.062(1) and 627.151, F.S.

2003, Senate Bill 50-A established subplan D in the JUA to provide coverage for small employers (15 or fewer employees).⁴ Although rates in this subplan were capped at 25 percent over the voluntary market rates for employers, the policies were assessable meaning that these employers could be assessed for additional premiums to cover any deficits in the subplan. At the time, the JUA estimated that its premiums for subplan D should have been 2.57 times higher than the voluntary market premium to remain actuarially sound; hence, it projected subplan D would likely incur a deficit. Because of these premium caps in subplan D, the JUA could not charge actuarially sound rates, resulting in a \$9.9 million deficit as of December 31, 2003. Prior to the 2004 Session, the JUA recognized an \$18.3 million deficit attributable to subplan D, as of March 31, 2004.

In 2004, the Legislature provided significant changes to the Florida Workers' Compensation Joint Underwriting Association that were designed to address the growing deficit in subplan D and to address availability and affordability of coverage for small employers that are new businesses or have good loss experience. This legislation, House Bill 1251⁵:

- Provided a one-time appropriation of \$10 million from the Workers' Compensation Administrative Trust Fund (WCATF) in the Department of Financial Services to fund any deficit in the JUA. Additionally, the bill authorized the JUA to request periodic transfers, not to exceed a total of \$15 million, from a contingency reserve established and funded through the WCATF fund to cover any remaining subplan D deficits, subject to approval by the Legislative Budget Commission. The Governor subsequently vetoed the \$10 million appropriation to the JUA.
- Restructured the JUA by eliminating the subplans and creating three tiers with eligibility based on an employer's loss experience, effective July 1, 2004. Tier 1 provides coverage for employers that have an experience-rating modification factor of less than 1.0 or, if nonrated, the employers must have a continuous three-year history of workers' compensation coverage and a good loss history, as specified. Tier 2 provides coverage for new employers, employers with moderate experience (experience-rating modification factor equal to or greater than 1.0 but not greater than 1.10), and employers with good experience who do not have a continuous 3-year history of workers' compensation coverage. Tier 3 provides coverage for all other employers.
- Capped premiums in Tier 1 and Tier 2 at 25 percent and 50 percent above the premiums of the voluntary market, respectively, until there is sufficient experience for the JUA to establish actuarially sound rates for the tiers, but no earlier than January 1, 2007. Employers in Tier 3 will be charged actuarially sound rates and only these policies will be assessable meaning that policyholders could be assessed additional premiums to cover any deficits.
- Funded any deficits in Tier 1 or Tier 2 or any deficit remaining from any of the former subplans by an assessment on all workers' compensation policies in the voluntary market for a period of 1 year. These "below-the-line" assessments may not be levied after July 1, 2007. The JUA is authorized to request funding for any deficit in Tier 3 in the event assessments on Tier 3 policyholders are inadequate to fund such a deficit. Former subplan D policyholders will not be subject to assessments for the funding of any deficits.

⁴ Ch. 2003-412, L.O.F.

⁵ Ch. 2004-266, L.O.F.

- Required the Office of the Auditor General to conduct an operational audit of the JUA and engage an independent actuary to evaluate the adequacy of the rates and reserves of the JUA and report to the Legislature no later than December 31, 2004.

The Office of the Auditor General (OAG) subsequently released its report in December 2004. The report included the following findings:

1. The OAG's contracted actuary's review of the JUA's reserves, reported as of December 31, 2003, and the rates established in its July 7, 2004, rate filing, concluded that the JUA's actuary determined the best estimate of required reserves using an undocumented and unquantified approach, and established a range of reasonableness that produced an upper bound that is too high in relation to the best estimate of required reserves. In addition, the JUA board of governors exercised additional conservatism by reporting reserves that were \$8.4 million higher than the JUA actuary's best estimate of required reserves.
2. The JUA did not demonstrate, of record, that its "controllable costs," or compensation paid to its policy administration service provider, were reasonable. In addition, the JUA has not recently provided for a cost/benefit analysis to determine whether its essential functions are more efficiently handled by JUA staff or by independent contractors.
3. The JUA's basis for awarding at-risk compensation to executive staff was not clear because the JUA had not established specific performance evaluation rating factors for each staff member. In addition, the basis for the allocation of a special project bonus paid to executive staff was not documented.
4. The JUA has not subjected most of its contractual services to a competitive selection process since 1995.⁶ In addition, the JUA had no written agreement with its contracted General Counsel; had an insufficiently detailed written agreement with its independent auditors; made payments to the General Counsel and independent auditors that were not supported by sufficiently detailed invoices; and did not properly bill the contracted service provider for its share of audit costs.
5. The JUA generally did not monitor, of record, the contracted service provider's performance regarding producer commission payments, payroll audits, loss control surveys, or the handling of delinquent accounts.
6. The JUA did not verify producer commissions calculated and paid by its contracted service provider.
7. The contracted service provider did not always perform required preliminary payroll audits, or perform final and cancellation payroll audits within the period specified in the JUA's Operations Manual.
8. The contracted service provider did not always perform required loss control surveys, or perform on-site surveys, contrary to the JUA's Operations Manual. In addition, the Operations Manual does not address requirements for surveys of policyholders with multiple locations.
9. The JUA's percentage of uncollected written premiums appears to be high, which may be at least partially due to untimely cancellation and final audits or to an insufficiently aggressive collection policy. Additionally, the contracted service provider did not always

⁶ Recently, the JUA advertised in the Florida Administrative Weekly that it was soliciting proposals to provide policy administration services. (March 4, 2005).

- place delinquent accounts with the designated collection agency within the period specified in the JUA's Operations Manual.
10. The JUA has generally not measured the effectiveness of its depopulation methods to ensure it is accomplishing the intent of s. 627.311(5)(c)4., Florida Statutes.

To assist the Legislature in further addressing the impact of Senate Bill 50-A on the JUA, SB 50-A required the JUA to submit a report to the Legislature no later than January 1, 2005. The JUA recommended that the Legislature extend the expiration date for accessing funds from the contingency reserve from January 1, 2007 to January 1, 2012.⁷ According to the JUA report, the obligations of the JUA arising out of subplan D policies will continue long after the scheduled January 1, 2007, expiration date for the contingency reserve. The JUA also recommended that the Legislature increase the amount of the contingency reserve by \$6 million, to a total of \$21 million. According to the JUA cash flow model submitted to OIR on December 28, 2004, even if the JUA is able to access the \$21 million originally established in the contingency reserve, it will fall short \$5.5 million of funding the projected deficit in subplan D. The JUA report also recommended that the Legislature require rates in Tiers 1 and 2 be actuarially sound, effective July 1, 2005, rather than January 1, 2007. The JUA projects that Tiers 1 and 2 will be deficit positions because of the caps and recommends lifting the caps earlier to mitigate the effects of the projected deficits.

The JUA report also projected that, as of December 1, 2004, it will have a deficit of \$11.6 million (the sum of a projected surplus of \$6.8 million in subplans A, B, and C, and a projected deficit of \$18.4 million in subplan D). The JUA indicated that it did not have sufficient data at this time to project deficits or surplus in the new tier rating plans at this time.

As of November 30, 2004, the JUA reported 2,275 subplan D policies and 472 subplans A, B, C policies in runoff. In addition, there were 148 Tier 1 policies, 1,098 Tier 2 policies, and 419 Tier 3 policies. These 4,412 policies in force for all of the subplans represented approximately \$46 million in written premium.

Presently, all of the state-created residual markets or insurers of last resort are administered and located in Tallahassee with the exception of the Workers' Compensation Joint Underwriting Association which is located in Sarasota, Florida. Citizens Property Insurance Corporation, the Florida Automobile Joint Underwriting Association, the Florida Medical Malpractice Joint Underwriting Association, and the Florida Health Insurance Plan are located and administered in Tallahassee, Florida.

III. Effect of Proposed Changes:

Section 1 amends s. 627.311, F.S., to require the Workers' Compensation Joint Underwriting Association (JUA) to establish and maintain its headquarters in Tallahassee. Presently, the JUA is located in Sarasota, Florida.

⁷ Florida Workers' Compensation Joint Underwriting Association, Inc. *Report to the President of the Senate, the Speaker of the House of Representatives, the chair of the Senate Banking and Insurance Committee, and the chair of the House Insurance Committee*, December 20, 2004.

The section increases the number of members on the JUA board of governors from nine to eleven members. The number of members appointed by the Financial Services Commission would be increased from three to five. The composition of the remaining members would be unchanged by the bill, two elected by the twenty domestic workers' compensation insurers, two elected by the top twenty foreign workers' compensation insurers, one person appointed by the largest property and casualty agents' association in Florida, and the consumer advocate appointed by the Chief Financial Officer.

The bill clarifies that the meeting minutes of the board of governors are subject to ch. 286, F.S. This chapter requires all meetings and minutes of such meetings of any board or commission or any agency or authority of the state are open to the public, except as otherwise provided in the statutes or the Constitution.

The bill requires the JUA to establish procedures for the competitive selection of service providers to ensure that services are provided in the most cost-effective and efficient manner. The bill requires the JUA to provide reasonable notice to potential servicing carriers of its intent to solicit bids for the procurement of such services by providing notice in the Florida Administrative Weekly and at least one newspaper of general circulation in Florida, or in at least two business trade journals.

The JUA is required to expand its annual review of costs associated with administration and servicing of policies to include a review of the general administration of the plan. The bill requires this review to specifically evaluate how goods and services can be procured in the most cost-effective and efficient manner.

The bill revises the rate approval process for the JUA by requiring prior approval of its rates by the Office of Insurance Regulation before the rates can be used. Carriers in the voluntary market are presently subject to this type of rate regulation. Currently, the JUA rates are subject to "use and file" which means that the JUA can immediately establish and implement its own rates without prior approval from the OIR. However, if the OIR subsequently finds that the rates are excessive after its review, the JUA would be required to refund any excess premiums to policyholders under current law.

The bill transfers two general provisions relating to plans and associations including the JUA, to two newly created sections to provide greater clarity.

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:

Since the Workers' Compensation Joint Underwriting Association (JUA) will now be required to obtain approval of its rates prior to using the rates, the burden will be on the JUA to demonstrate that the rates comply with the statutory requirements established for Tiers 1, 2, and 3 and part I of ch. 627, F.S., relating to rates and rating organizations. Part I of ch. 627, F.S., provides that rates not be inadequate, excessive, or discriminatory. This change will ensure that any rates implemented by the JUA are not excessive.

There will be indeterminate costs associated with relocating the JUA to Tallahassee.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

Barcode 603530 by Banking and Insurance:

Technical amendment to correct a cross reference.

Barcode 840258 by Banking and Insurance:

Technical amendment to clarify reference to Workers' Compensation Joint Underwriting Association and to correct a cross reference.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
