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: CS/SB 2184

SPONSOR: Banking and Insurance Committee and Senator Baker

SUBJECT: Insurer Insolvency

DATE: April 13, 2005 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Deffenbaugh	Deffenbaugh	BI	**Favorable/CS**
2.			CA	
3.			GE	
4.			GA	
5.				
6.				

I. Summary:

This bill makes the following changes regarding insurance company insolvencies and obligations of the Florida Insurance Guaranty Association (FIGA), which pays claims of insolvent property and casualty insurers:

- Authorizes FIGA to pledge part or all of its current maximum 2 percent of premium assessment against property and casualty insurers to fund revenue bonds issued by a municipality or county, in order to pay FIGA-covered claims arising from the insolvency of an insurer resulting from a hurricane. A municipality or county affected by the hurricane would be authorized to issue bonds for this purpose.

- Provides that FIGA covers claims of a corporation or business that is a policyholder or claimant of an insolvent insurer if the business has its principal place of business in Florida, rather than basing coverage on being incorporated in Florida.

- Provides that a proof of claim form to seek recovery from FIGA is not required if adequate claims file documentation exists within the records of the insolvent insurer, and is not required for payment of unearned premium refunds.

- Requires the Department of Financial Services, as receiver of an insolvent Florida insurer, to use any collateral held by the insurer to secure a deductible amount owed by the policyholder, to fund or reimburse claims payments, rather than being considered part of the estate of the insurer available to general creditors.

This bill substantially amends the following sections of the Florida Statutes: 631.181, 631.54 and 631.57.

This bill creates the following sections of the Florida Statutes: 631.1915 and 631.695.

II. Present Situation:

In Florida, regulation of insurance is shared by the Department of Financial Services (DFS) and the Office of Insurance Regulation (OIR). The state's Chief Financial Officer (CFO) heads DFS while the head of OIR is the Governor and Cabinet members sitting as the Financial Services Commission, who have rulemaking authority for OIR and who appoint a Commissioner of Insurance (also referred to as the Director) who is agency head of OIR for purposes of final orders. In general, OIR has responsibility for insurance company regulation, including solvency regulation. But, the DFS is appointed as receiver of an insolvent insurer and has oversight responsibility for the various insurance guaranty associations.

Chapter 631, F.S., relates to insurer insolvency and guaranty payments and governs the receivership process for insurance companies in Florida. Federal law specifies that insurance companies cannot file for bankruptcy. Instead, they are either "rehabilitated" or "liquidated" by the Division of Rehabilitation and Liquidation (the Division) of DFS. By law, a delinquency proceeding is initiated by the Division in circuit court against any insurer determined to be insolvent or experiencing an impairment of its capital reserves or surplus. The court may issue an order of liquidation, rehabilitation, reorganization, or conservancy.

Insurance Guaranty Funds

Most states, including Florida, have insurance guaranty associations that are required to pay outstanding claims of insolvent insurance companies, up to certain limits. In Florida, there are four guaranty associations created in chapter 631, F.S., for: 1) property and casualty insurance; 2) life and health insurance; 3) workers' compensation insurance; and 4) health maintenance organizations. The guaranty association that is the subject of this bill is for property and casualty insurance, the Florida Insurance Guaranty Association (FIGA).

Florida's guaranty associations are comprised of insurer representatives. Insurers are required by law to participate in guaranty associations as a condition for transacting business in the state. Monies available through a guaranty association for claims settlement and premium refunds are paid by insurers as a percentage of their total collected premiums. The percentage of premiums payable to a guaranty association is determined by law, although nationally it typically ranges from 1-3 percent.

Florida Insurance Guaranty Association (FIGA)

The Florida Insurance Guaranty Association (FIGA) pays unpaid property or casualty insurance claims, other than workers' compensation, of insolvent insurance companies licensed in Florida.[1] FIGA does not cover the first $100 of a claim or amounts in excess of $300,000 per claim,

[1] Part II of chapter 631, F.S.

except with respect to policies covering condominium associations, the obligation is up to $100,000 multiplied by the number of condominium units FIGA also pays unearned premium claims.[2]

FIGA is divided into three accounts and funding is provided by assessments against authorized insurers, as needed for the payment of covered claims and costs of administration. The maximum annual assessment against each insurer is 2 percent of the insurer's net direct written premiums in the state in the prior year, for the types of insurance in each account. The three accounts are: 1) auto liability, 2) auto physical damage, and 3) all other property and casualty insurance, other than workers' compensation.[3] This "all other" account includes property insurance (such as claims resulting from hurricane-related insolvencies), personal liability, commercial liability, commercial multi-peril, professional liability, and all other types of property and casualty insurance, other than automobile and workers' compensation.

In general, assessments against insurers may be passed on to their policyholders. Specifically, the law provides that the assessments "shall be included as an appropriate factor in the making of rates."[4] This indicates that such costs may be included in the insurer's rate filing, subject to approval by the Office of Insurance Regulation.

The last FIGA assessments occurred in 2002. According to documents provided by FIGA, in December 2002, member insurers writing policies covered by the auto liability account were assessed 1.125 percent of their net direct premiums collected in 2001. FIGA made an assessment for the auto physical damage account in 2002 at a rate of 0.75 percent. There was no assessment in 2002 for the all-other account. According to FIGA, it has assessed the maximum of 2 percent only once in the past 11 years.

Local Government Revenue Bonds

Article VII of the Florida Constitution governs finance and taxation by the state and its political subdivisions. In that article, the state and its political subdivisions, including municipalities and counties, are authorized to issue bonds. In most cases, bonds issued either by a city or a county are tax exempt; the tax-exempt status generally makes bonds issued by governmental entities an attractive investment instrument.

Section 166.111, F.S., authorizes every municipality to borrow money and issue bonds to finance the undertaking of any capital or other project for the purposes permitted by the State Constitution and may pledge the funds, credit, property, and taxing power of the municipality for the payment of such debts and bonds.

FIGA Bonds after Hurricane Andrew

On August 24, 1992, Hurricane Andrew devastated much of Dade County. Ten insurers were declared insolvent due to their inability to settle claims received following Hurricane Andrew.

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[2] Section 631.57(1)(a), F.S.
[3] Section 631.55, F.S.
[4] Section 631.57(3)(c), F.S.

FIGA did not have sufficient assets to cover the estimated $400 million to $500 million in unpaid claims of the insolvent insurers. The regular 2 percent assessment for the "all other" account" generated only about $65 million in addition to other recoveries available to FIGA.

In the December, 1992 special session, legislation was enacted to address FIGA's shortfall, in order to pay claims of policyholders of insolvent insurers.[5] Under the law, the city of Homestead was authorized to issue municipal revenue bonds of up to $500 million to fund FIGA obligations resulting from the multiple insolvencies that resulted from Hurricane Andrew claims. The revenue bonds issued by the city of Homestead did not pledge any assets or taxing authority of Homestead. Rather, the Legislature authorized FIGA to charge its member insurers a special 2 percent assessment of premiums written in the "all other account" in addition to the regular assessment of up to 2 percent. The additional assessment served as the revenue stream pledged to retire the bonds issued by Homestead. The full 2 percent special assessment was levied each year from 1993 until 1996, and at a 0.75 percent rate in 1997. In addition, the 2 percent regular assessment was levied in 1993, and at much lower rates in 1994, 1996, and 1997. By 2000, FIGA had sufficient funds to defease (i.e. "pay off") the Homestead bonds, although those funds were reserved to make the regular annual payments until the bonds expired in 2003.

The 2004 Florida Hurricane Season

The 2004 hurricane season was very active with four hurricanes causing damage to Florida within 45 days of each other. According to OIR, as of March 29, 2005, insurers had paid $16.4 billion for claims arising from the four hurricanes occurring in 2004; the total number of claims reported from all hurricanes is over 1.6 million; and gross property losses are estimated at $22.8 billion.

To date, only one insurer, the American Superior Insurance Company, has been declared insolvent as a result of claims filed following the 2004 hurricanes. According to a spokesperson for FIGA, an assessment is not expected to be necessary to fund FIGA obligations for this insolvency, which should be covered by the $118 balance in FIGA's "all other account" as of 12/31/04 and other FIGA recoveries in 2005. But, FIGA obligations for other insolvencies that have occurred, or may occur, remains a moving target as estimates are revised over the course of the year. According to FIGA, the 2 percent regular assessment in the "all other" account would have generated about $188 million in 2004.

Definition of "Residency" for Covered Claims of Corporations

The current law defines a "covered claim" under FIGA as an unpaid claim for a claimant or insured that is a resident of this state at the time of the insured event or the property from which the claim arises is permanently located in this state.[6] The law does not define "resident" for this purpose, but FIGA currently interprets its meaning as the *state of incorporation* of a corporate entity. According to representatives from FIGA, no Florida appellate court has addressed the issue of how to determine the residency of an entity for purposes of triggering guaranty association coverage under FIGA. However, numerous cases in Florida conclude for purposes

[5] Chapter 92-345, L.O.F.
[6] Section 631.54(3), F.S.

other than guaranty association coverage that corporate residency is determined solely based on the state of incorporation. This means that an entity whose primary business location is in Florida, but that is incorporated in a state other than Florida, must seek reimbursement for unpaid claims from the appropriate guaranty association of the state where the business entity is incorporated.

However, numerous state courts in other jurisdictions with similar guaranty association laws have determined for purposes of determining guaranty association coverage, residency of an entity is based on its *principal place of business* rather than its state of incorporation. According to FIGA, the majority of jurisdictions use the principal place of business rule for this purpose. In cases where Florida and another state both initially deny guaranty fund coverage due to a conflict in the corporate residency test, the two states typically mediate a resolution to assure that the claims are covered.

Proof of Claim

Claimants are required to file “proof of claim” forms with the receiver (department) for any unpaid claims against an insurer in receivership, which must include certain information and be filed within the time limits specified in the receiver’s notice.[7] This applies not only to claims covered under the policy, but also to policyholder claims for the return of unearned premium, which is covered by each of the guaranty funds, subject to a $100 deductible in FIGA. This process is reportedly time consuming and often results in insureds not receiving a return of their unearned premium for months or even a year after an insolvency.

“Deductible Deposits” or Policyholder Collateral

Many business purchase workers compensation or liability coverage obtain a high deductible policy, which may be as high as $500,000 per claim or more. For such policies the insurer is typically required to pay the first dollar of the claim and then is entitled to recovery from the policyholder up to the amount of the deductible. For this reason, the insurer will require the employer to maintain a deposit with the insurer to be applied against any claims of the employers.

The current Florida law does not specifically address how the department, as receiver of an insolvent insurer, is to consider deductible deposit accounts held by, or owed to, the insurer. According to the department, it considers such deposits to be tied to the claim against the deposit and are paid to the appropriate guaranty fund to pay claims to third parties (such as injured workers with workers’ compensation claims). The other option would be to consider such deposits as assets of the insurer, in which case they would be swept into the estate of the insurer and be distributed to all creditors, in the priority order specified by law. In that case, the guaranty funds may get pennies on the dollar of the deductible funds, and could delay payment to claimants. Recently, insurance regulators in Pennsylvania considered such deposits to be assets of the insolvent insurer, rather than claim amounts owed to policyholders, and did not distribute such funds to the appropriate guaranty funds.

[7] Section 631.181, F.S.

III. Effect of Proposed Changes:

Section 1 amends s. 631.181, F.S., regarding the proof of claim form of "signed statement" that must be filed by claimants with the receiver (department) of an insolvent insurer placed in receivership. The bill provides that the signed statement is not required if adequate claims file documentation exists within the records of the insolvent insurer. It also provides that the proof of claim form is not required for payment of unearned premium if the receiver certifies to the guaranty fund that the records of the insolvent insurer are sufficient to determine the amount of unearned premium owed to each policyholder. This should result in returning unearned premiums to policyholders much more quickly.

Section 2 creates s. 631.1915, F.S., to establish requirements that the department must follow as receiver of an insolvent insurer regarding any collateral held by the insurer or receiver to secure the obligations of a policyholder under a deductible agreement. According to the department, these requirements are consistent with how the department has handled such accounts. Such amounts shall not be considered an asset of the insurer (i.e., not part of the estate), but must be used to secure the policyholders' obligation to fund or reimburse claims payments within the agreed deductible amount. That is, such amounts will be made available to the appropriate guaranty fund that covers such claims to be paid to claimants (such as injured workers having claims against an insolvent workers' compensation insurer). The bill provides additional detail regarding how the department as receiver should administer such collateral accounts under various scenarios, such as whether a claim subject to a deductible account is, or is not, covered by any guaranty association.

Section 3 amends s. 631.54, F.S., to revise the definition of "covered claim" to specify that for an entity other than a person, i.e., a business or other legal entity, the residence of the entity is the state where the entity's principal place of business is located. This would change the current interpretation applied by FIGA that the state of incorporation is the state of residency of a corporation.

According to representatives from FIGA, this will conform the Florida law to the majority of jurisdictions that use the principal place of business test for determining residency of a corporation for purposes of guaranty fund coverage. So, corporations and business entities with their principal place of business in Florida will be covered by FIGA if their insurer is rendered insolvent. Corporations incorporated in Florida but which have their principal place of business in another state will be required to seek reimbursement from the other state's guaranty association.

Section 4 amends s. 631.57, F.S., to authorize FIGA to contract with a city or county to issue tax-exempt revenue bonds for funding obligations of FIGA for covered claims of insurers rendered insolvent as a result of a hurricane. The provision is based on the law enacted by the 1992 Legislature to enable FIGA to pay the hurricane-related claims of insurers who became insolvent following Hurricane Andrew. However, the prior act authorized FIGA to impose an additional emergency assessment of 2 percent of premium, but the bill does not authorize any additional assessment. Instead, it allows the current maximum 2 percent assessment to be used to provide a revenue stream for a bond issuance.

Section 5 creates s. 631.695, F.S., to authorize any city or county substantially affected by a category 1 or greater hurricane, to issue bonds to fund an assistance program in conjunction with FIGA, to pay covered claims arising from the insolvency of an insurer determined by FIGA to have been a result of a category 1 or greater hurricane. Such bonds would be secured by the current assessments that can be levied by FIGA, and may be for a term not to exceed 30 years. The bond proceeds may be used by FIGA to settle unpaid claims or to refund unearned premiums to citizens of the state affected by the hurricane, even if the claimant's residence is not in the city or county that issues the bonds.

The bill makes legislative findings that it is necessary for the protection of the public health, safety, and general welfare of the residents of this state, and declared to be an essential public purpose, to permit municipalities and counties to take such actions as will provide relief to claimants and policyholders having claims against insolvent insurers. Related findings are made regarding to the personal hardship to persons and families who suffer losses during a hurricane and the need for claims to be settled expeditiously. The findings also recognize the success of the FIGA bonds issued in 1993 and their potential for future use. The legislative findings likely will be used as part of the supporting documents that accompany any future bond issue for hurricane recovery.

The bill authorizes several uses for bonds issued for hurricane recovery. Among the authorized uses is the payment of covered claims of an insolvent insurer; to refinance or replace previous borrowings; to fund reserves for the bonds; to pay expenses incident to bond issuance; and other similar enumerated purposes. The bill provides that the state covenants (promises) not to take any action that could endanger the availability of funds to repay the bonds.

The bill requires FIGA to file a report annually with the Senate President, the Speaker of the House, and the Chief Financial Officer on the status of the bond proceeds.

Section 6 provides that no provision of s. 631.57, F.S. (as amended by Section 4 of the bill) or s. 631.695, F.S. (as created by Section 5 of the bill) shall be repealed until such time as the principal and interest on all bonds issued pursuant to such sections have been paid in full or adequate provision for payment has been made.

Section 7 provides a severability clause if any provision of this act is held invalid.

Section 8 provides an effective date of upon becoming law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

See, Private Sector Impact, below.

B. Private Sector Impact:

By allowing bonds to be issued to fund FIGA obligations, policyholders of insurers rendered insolvent due to a hurricane would be more likely to have their claims paid by FIGA in a timely manner if the revenues generated by the maximum assessment are insufficient to fund these obligations.

Corporations that have their principal place of business in Florida will have their insurance claims covered by FIGA if their insurer is rendered insolvent. Corporations that are incorporated in Florida, but do not have their principal place of business in Florida will no longer be covered by FIGA, and would be required to look to the guaranty fund of the state of its principal place of business. According to representatives of FIGA, in cases where a conflict exists, the state guaranty funds will cooperatively mediate a resolution to assure that claims are covered.

Policyholders and claimants of an insolvent Florida insurer, as well as affected guaranty funds, would benefit by requiring the department, as receiver, to use any deductible account to pay claims, rather than being swept into the estate of the insolvent insurer to be available to all creditors. (This is consistent with current department practice.)

C. Government Sector Impact:

A city or county that issues revenue bonds under the bill is not required to repay the bonds from its own revenues. Rather, FIGA is authorized to charge its member insurers an assessment of up to 2 percent annually (the current cap), for the life of the bonds. Expenses associated with issuing the bonds will be paid from bond proceeds. This means the costs to a city or county that issues the bonds should be negligible.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.

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