HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 97 CS Motor Vehicle Service Agreement Companies
SPONSOR(S): Mahon
TIED BILLS: **IDEN./SIM. BILLS:** SB 1426

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Committee	18 Y, 0 N, w/CS	Sayler	Cooper
2) Civil Justice Committee	4 Y, 0 N	Lammers	Billmeier
3) Commerce Council			
4)			
5)			

SUMMARY ANALYSIS

Motor vehicle service agreement companies (service companies) sell motor vehicle service agreements (MVSAs) that indemnify a service agreement holder for a motor vehicle against loss caused by failure of any mechanical or other component part that does not function as it was originally intended. These companies must be licensed by the Office of Insurance Regulation and must submit forms for approval.

Currently, service companies operating under part I of Chapter 634, F.S., must decide whether MVSAs that they issue to purchasers will be covered by the statutorily mandated 50-percent reserve or a contractual liability coverage that covers 100-percent of the service agreements written.

This bill allows service companies writing MVSAs that maintain net assets of at least $7.5 million to simultaneously use the 50-percent reserve or the contractual liability coverage when assigning a "specific block of new service agreements." It defines "specific block of new service agreements" as the service agreements sold by a single designated licensed salesperson. These service companies will be able to choose how to assign a block of new service agreement obligations will be covered, either by the 50-percent reserve or a contractual liability insurance policy.

This bill requires the service company to be able to distinguish how each individual MVSA is covered.

This bill requires service companies to include the following information in the detailed service agreement record – "whether the agreement is covered by contractual liability insurance or the unearned premium reserve account."

This bill provides a minimal positive fiscal impact for a very narrow spectrum of motor vehicle service agreement providers.

This bill takes effect July 1, 2005.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Provide limited government – This bill allows motor vehicle service providers with the requisite assets more flexibility in assigning whether individual motor vehicle service agreements (MVSAs) will be covered by a 50-percent reserve or a contractual liability insurance coverage policy.

B. EFFECT OF PROPOSED CHANGES:

Background

Warranty Associations: Motor Vehicle Service Agreement Companies

The Department of Financial Services (department) is authorized to regulate the salespersons and representatives who sell warranties (as part of the department's authority to license and regulate insurance agents). Warranty associations are regulated by the Office of Insurance Regulation (OIR) under chapter 634, F.S., and include motor vehicle service agreement companies (service companies), home warranty associations, and service warranty associations.

Service companies sell MVSAs that indemnify a service agreement holder for a motor vehicle against loss caused by failure of any mechanical or other component part that does not function as it was originally intended. Service companies are regulated exclusively under part I, chapter 634, F.S., except as otherwise provided in that part. Service companies must file their rates and premiums with OIR, but the rates are not subject to disapproval by OIR. These service companies must be licensed by the Office of Insurance Regulation and must submit forms for approval.

The Insurance Code authorizes a service company to guarantee or warrant a consumer's motor vehicle and its component parts for any mechanical failure that arises out of the use or operation of the vehicle after the expiration of the manufacturer's warranty.

MVSAs are typically marketed through automobile dealerships, and the dealerships may obtain an agent license to market MVSAs. The employees of the automobile dealership may sell MVSAs under the dealership's license.

Solvency and Licensure Requirements

In order to be licensed, a service company must meet financial solvency, marketing and sales requirements, and be examined by OIR every three years.[1] The financial solvency provisions generally require a service company to have and maintain minimum net assets of $500,000.[2] The solvency provisions, among other things, also require a service company to maintain an unearned premium reserve consisting of unencumbered assets equal to a minimum of 50-percent of the unearned gross written premium on each MVSA, and require amortization of this reserve pro rata over the duration of the service agreement. These assets must be held in the form of cash or invested in securities.[3] However, a service company does not have to maintain reserves of 50-percent of its unearned gross written premiums if the company complies with the following:[4]

[1] Section 634.041(5), F.S.
[2] *Id.* at (6).
[3] *Id.* at (8)(a)1.
[4] *Id.* at (8)(b).

- The company must purchase and maintain a contractual liability insurance policy to insure 100 percent of its service contract obligations.
- If the service company does not meet its contractual obligations, the contractual liability insurance policy binds its issuer to pay or cause to be paid to the service agreement holder all legitimate claims and cancellation refunds for all service agreements issued by the service agreement company while the policy was in effect.
- If the issuer of the contractual liability policy is fulfilling the MVSAs covered by the contractual liability policy and the service agreement holder cancels the service agreement, the issuer must make a full refund of any unearned premium to the consumer, subject to the cancellation fee provisions of s. 634.121(5), F.S. The sales representative and agent must refund to the contractual liability policy issuer their unearned pro rata commission.
- The policy may not be canceled, terminated, or non-renewed by the insurer or the service company unless a 90-day written notice has been given to the department by the insurer before the date of the cancellation, termination, or non-renewal.
- The service company must provide OIR with claims statistics.

All funds or premiums remitted to an insurer by a service company must remain in the care, custody, and control of the insurer and must be counted as an asset of the insurer.[5] However, this requirement does not apply when the insurer and the service company are affiliated companies and members of an insurance holding company system.[6] If a service company chooses to comply with the requirements listed above but also maintains a reserve to pay claims, such reserve may only be considered an asset of the covered service company and may not be simultaneously counted as an asset of any other entity.[7]

A service company wishing to offer vehicle protection service agreements must meet the requirements set forth in the list described above and certain other requirements when purchasing contractual liability insurance coverage.[8] The contractual liability insurance policy (CLP) must be issued by an insurance company not affiliated with the service company, unless the insurance company has issued a contractual liability insurance policy to a service company on or before January 1, 2002. Additionally, service agreements providing vehicle protection expenses may be sold only to a service agreement holder that has in-force comprehensive motor vehicle insurance coverage for the vehicle to be covered by the service agreement.[9]

Under current law, a service company must satisfy all the requirements of part I of chapter 634, F.S. A service company under chapter 634 must maintain contractual liability for 100 percent of its outstanding liabilities under such agreements or maintain an unearned premium reserve account equal to 50 percent of the unearned gross premiums and 15 percent of such premiums must be deposited with the OIR. A motor vehicle service agreement company is currently required to maintain minimum net assets of $500,000 to maintain its license to write service agreements.

According to s. 634.041(9), F.S., service companies may not utilize both the 50-percent reserve and contractual liability insurance coverage simultaneously to cover its obligations. Accordingly, a service company may have CLP coverage on MVSAs previously sold and sell new service agreements covered by the 50-percent reserve requirement; or a service company may have contractual liability insurance coverage on new MVSAs sold and have the previously sold service agreements covered by the 50-percent reserve requirement.[10] It just cannot do both simultaneously on new agreements being

[5] *Id.* at (8).
[6] *Id.*
[7] *Id.*
[8] *Id.* at (11)(a).
[9] *Id.*
[10] *Id.*

sold.[11] The service company must be able to distinguish how each individual service agreement is covered, either by the 50-percent reserve or by CLP coverage.[12]

As a result, a company utilizing the 50-percent reserve must not allow its ratio of gross written premium in force to net assets to exceed 10 to 1. A service company may not utilize both the CLP and the 50-percent reserve simultaneously. It must choose one or the other. An MVSA writer may switch back and forth between using the CLP coverage and the premium reserve account, but may not use both during the same period of time.

According to OIR, the purpose of not mixing these methods of coverage is consumer protection. It is designed to prevent a contractual liability insurance coverage company from claiming that a certain block of MVSAs are not covered when the service company claims that they are covered. Such disputes could leave a holder of a valid service agreement without coverage. By requiring all motor vehicle service agreements written within a specified period of time to be covered by either a contractual liability insurance policy or by a 50-percent reserve, according to OIR, this can reduce the likelihood of disputes between a CLP company and a service company regarding what service agreements are covered.

HB 97

This bill allows service companies that maintain net assets of at least $7.5 million to simultaneously use the 50-percent reserve or the contractual liability coverage for "specific block[s] of new service agreements." It defines "specific block of new service agreements" as the service agreements sold by a single designated licensed salesperson. These service companies will be able to choose how a block of new service agreement obligations will be covered, either by the 50-percent reserve or a contractual liability insurance policy. For instance, an automobile dealership is an example of a designated licensed salesperson. According to OIR, approximately 10 service companies could qualify at the $7.5 million level of net assets.[13]

This bill requires the service company to be able to distinguish how each individual MVSA agreement is covered. It requires service companies to include the following information in the detailed service agreement record – "whether the agreement is covered by contractual liability insurance or the unearned premium reserve account."

This bill shall take effect July 1, 2005.

C. SECTION DIRECTORY:

Section 1 – Amends s. 634.041(9), F.S., to add paragraph (b) and allow a service company with $7.5 million in net assets to simultaneously use 50-percent reserve or CLP coverage for specific blocks of MVSAs written by a designated licensed salesperson.

Section 2 – Amends s. 634.136, F.S., to require coverage information to be included within a detailed service agreement register for an MVSA.

Section 3 – This bill provides an effective date of July 1, 2005.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

[11] *See id.*
[12] *Id.*
[13] Email from OIR, April 4, 2005, on file with the Insurance Committee

1. Revenues:

   This bill is not anticipated to increase or decrease revenues.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   This bill is not anticipated to increase or decrease revenues.

2. Expenditures:

   The bill does not require local governments to spend funds or to take action requiring the expenditure of funds.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This bill provides a minimal positive fiscal impact for a very narrow spectrum of motor vehicle service agreement providers.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   The bill does not require counties or municipalities to spend funds or to take action requiring the expenditure of funds. The bill does not reduce the percentage of a state tax shared with counties or municipalities. The bill does not reduce the authority that municipalities have to raise revenue.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

OIR notes that this bill will make monitoring of the financial condition of service companies more difficult.[14] According to OIR, this bill could decrease the amount of consumer protection that current law provides and could open the door to disputes over whether the MVSA is covered by a 50-percent reserve or a CLP policy.[15]

The following is a response from OIR regarding how to resolve this issue: the Office of Insurance Regulation recommends "…if a contractual liability insurance policy is used for specific blocks of

[14] Office of Insurance Regulation HB 97 bill analysis on file with the Insurance Committee.
[15] Based on telephone conversations with OIR, March 29, 2005.

agreements, that the service company files with OIR endorsements to the contractual liability policy [that identify] the specific blocks of agreements … covered under the policy. Also, that the CLP will cover all claims out of the specific blocks if the service agreement company cannot or will not pay."[16]

OIR suggests that the net assets should be raised from $7.5 million to $10 million. According to OIR, approximately 10 companies could qualify at the $7.5 million level; whereas, approximately eight service companies could qualify at the $10 million level.[17]

Language very similar to HB 97 CS was amended onto HB 825 CS on March 30, 2005.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

The committee adopted two amendments that added language to the original bill. The first amendment raised the required net assets from $5 million to at least $7.5 million and provided a definition for "specific block of new service agreements." The second amendment required information about how the MVSA was covered to be included in its detailed service agreement register. This staff analysis incorporates both amendments.

[16] Email from OIR, April 4, 2005, on file with the Insurance Committee
[17] Id.