

# 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 1620

INTRODUCER: Banking and Insurance Committee and Senator Haridopolos

SUBJECT: Warranty Associations

DATE: March 8, 2006

REVISED: \_\_\_\_\_

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

---

## I. Summary:

Chapter 634, F.S., regulates warranty associations, including motor vehicle service agreement companies, home warranty associations, and service warranty associations. A home warranty may offer protection for kitchen and household appliances, heating and air conditioning systems; exposed plumbing, roofs; and exposed electrical systems. Motor vehicle service agreement companies typically offer automobile owners extended warranties, or a warranty beyond the terms of an automobile manufacturer's warranty. A service warranty association generally offers a warranty on a newly-purchased appliance or product for home use. The Office of Insurance Regulation regulates warranty associations. The committee substitute provides the following changes to laws governing warranty associations:

1. Prohibits an association from investing or lending association funds to any officer, director, or controlling shareholder;
2. Allows home warranty contract holders to cancel the contract within 10 days, with a refund of at least 95 percent of the premium and to cancel at any time, after the 10 days, with a refund of at least 90 percent of the unearned pro rata premium. Current law allows for cancellation within 10 days without penalty, but only for contracts offered in connection with a home equity loan; not contracts offered in connection with the sale of a home;
3. Provides that if a home warranty association elects to use a contractual liability insurance policy in lieu of establishing an unearned premium reserve, the policy must cover all home warranty contracts issued during the policy period whether or not the premium has been remitted to the insurer;

4. Allows a service warranty association to sell a warranty in connection with the sale of a home, without also being licensed as a home warranty association, if the warranty only covers systems and appliances and no structural component of a home; and
5. Allows a home warranty association to renew a home warranty more than nine times, the current statutory limit. A home warranty association also would be allowed to charge a higher rate to renew a warranty than the current cost to purchase a new warranty for the same home, which is currently prohibited.

This bill substantially amends the following section of the Florida Statutes: 634.301, 634.077, 634.312, and 634.336, and creates the following sections of the Florida Statutes 634.042, 634.3076, 634.336. The bill repeals the following section of the Florida Statutes: 634.345.

## II. Present Situation:

Pursuant to ch. 634, F.S., the Office of Insurance Regulation (OIR) regulates warranty associations, including motor vehicle service agreement companies, home warranty associations, and service warranty associations. Motor vehicle service agreement companies typically offer auto owners extended warranties, or a warranty beyond the terms of an auto manufacturer's warranty. A service warranty association generally offers a consumer a warranty on a newly-purchased appliance or product for home use, e.g., refrigerator, TV, stereo, among many other products. A home warranty may offer protection for kitchen and household appliances, heating and air conditioning systems; exposed plumbing, roofs; and exposed electrical systems. The OIR reports that approximately 170 warranty associations have been granted authority to sell warranties in the state, of which 20 are licensed home warranty associations.

The OIR is responsible for the approval of forms, examination of warranty associations, and monitoring of reserve requirements, among other duties. For informational purposes only, each warranty association is required to file with the OIR the rate to be charged for each warranty. The current laws governing warranty associations do not prohibit the respective associations from using association funds to secure the debts of, or otherwise offer, collateral for a security or debt instrument of directors, officers, or controlling shareholders of the association.

Section 634.3025, F.S., provides that home warranty associations are governed by the provisions of part II of ch. 634, F.S., and are exempt from all other provisions of the Insurance Code, except as otherwise provided. The law requires a home warranty association to file its application and other similar forms with OIR for approval under the provisions of s. 634.312, F.S. Current law requires the OIR to disapprove a home warranty association form if the form allows for more than nine annual renewals. The law also prohibits the OIR from approving a form if it allows a home warranty association to charge a higher premium to renew a warranty than the current price to purchase a new warranty for the same home, or from charging a fee to inspect the premises that are to be covered by the warranty.

Section 634.3077, F.S., requires a home warranty association to maintain a funded, unearned premium reserve account consisting of a minimum of 25 percent of the gross written premiums received by it from all warranty contracts in force. In lieu of establishing the minimum unearned premium reserve, an association may purchase contractual liability insurance which demonstrates to the OIR that 100 percent of the claims exposure is covered by such coverage.

A home warranty generally is offered in conjunction with the purchase either of a new home or the sale of an existing home. The law also authorizes a home warranty to be offered to a homeowner in conjunction with a home-equity loan or second mortgage of at least \$5,000. Similarly, if a homeowner undertakes home improvements with a value of at least \$7,500, the homeowner may purchase a home warranty to coincide with the improvements. Real estate agents, mortgage brokers, and closing agents are primary sources for sales of home warranties. In most cases, such warranties are offered to home buyers at the time a buyer is signing mortgage documents.

Under the provisions of s. 634.345, F.S., a purchaser of a home warranty sold in connection with a home equity loan may cancel within 10 days after purchase without penalty and receive a refund from the insurer or home warranty association. However, this requirement does not apply to warranties sold in connection with the purchase of a home. There is also no requirement for a home warranty contract to allow the purchaser to cancel and receive any type of refund after the initial ten period.

Section 634.301, F.S., requires a company to hold a home warranty license if that company sells a warranty at the time a home is sold and the warranty covers structural or non-structural components. Thus, a service warranty association licensed under part III of ch. 634, F.S. must also obtain a home warranty association license if those service warranties are offered at the time of the sale of the home.

### III. Effect of Proposed Changes:

**Section 1** creates s. 634.042, relating to prohibited investments and loans. A motor vehicle service agreement company is prohibited from investing or lending funds of the association to any director, officer, or controlling stockholder. This prohibition applies only to an investment or loan reported by the respective association in its financial statements after the third quarterly financial statement of 2006. Currently, the laws governing warranty associations currently do not prohibit the respective associations from using association funds to secure the debts of or otherwise offer collateral for a security or debt instrument of officers of the association.

**Section 2** amends s. 634.301, F.S., to provide that part III of ch. 634, F.S., to eliminate a dual licensure requirement affecting service warranty associations under certain circumstances. The definition of home warranty is amended to provide that it does not apply to a contract or agreement offered in connection with a sale of a residential property by a service warranty association in compliance with part III, provided such contract or agreement only relates to the systems and appliances of the covered residential property and does not cover any structural component of the residential property. This means a service warranty association may sell home warranties for appliances and heating and air conditioning systems, under its service warranty license, rather than obtaining a separate home warranty license, as well.

Under current law, an entity must hold a home warranty license if that entity sells warranties at the time a home is sold and the warranty covers structural or non-structural components. Thus, a service warranty association licensed under part III of ch. 634, F.S. must also obtain a home

warranty association license if those service warranties are offered at the time of the sale of the home.

**Section 3** creates s. 634.3076, F.S., relating to prohibited investments and loans. A home warranty association is prohibited from investing or lending association funds to any director, officer, or controlling stockholder. This prohibition applies only to an investment or loan reported by the respective association in its financial statements after the third quarterly financial statement of 2006. Currently, the laws governing warranty associations currently do not prohibit the respective associations from using association funds to secure the debts of or otherwise offer collateral for a security or debt instrument of officers of the association.

**Section 4** amends s. 634.3077, F.S., relating to reserve requirements of a warranty association, to provide that if the home warranty association elects to use a contractual liability policy (CLP) in lieu of establishing an unearned premium reserve, that the CLP must cover all home warranty contracts issued during the CLP period, whether or not the premium has been remitted to the insurer. This provision conforms to the CLP provisions for service warranty and motor vehicle warranty associations.

**Section 5** amends s. 634.312, F.S., relating to the filing and approval of forms by the Office of Insurance Regulation. The bill would authorize a home warranty association to renew a home warranty more than nine times, the current statutory limit. A home warranty association would also be allowed to charge a higher rate to renew a warranty than the current cost to purchase a new warranty. The bill continues the current statutory prohibition on charging an inspection fee before selling or renewing a home warranty contract.

The current law relating to a buyer's right to cancel is repealed in section 8 of the bill and new provisions are created in this section to address cancellation of a home warranty either by the warranty holder or the warranty association in connection with the sale of a home or a home equity loan. A home warranty contract is required to disclose the association's cancellation policy. A homeowner may cancel a home warranty within 10 days after the purchase and receive a full refund, less any claims paid during the first 10 days. However, an association also may withhold an administrative fee, not to exceed 5 percent of the purchase price.

If a warranty holder cancels his or her home warranty after 10 days, the association is required by the bill to refund the homeowner at least 90 percent of the unearned pro rata premium. However, if the warranty association cancels the warranty after the first 10 days, for any reason other than fraud or misrepresentation on the part of the homeowner, the association must refund all unearned pro rata premium to the homeowner.

Under current law, a purchaser may cancel within 10 days after purchase without penalty and receive a refund from the insurer or home warranty association only for contracts offered in connection with a home equity loan only; not contracts offered in connection with the sale of a home.

**Section 6** amends s. 634.366, F.S., relating to unfair methods of competition and unfair or deceptive acts or practices, to remove a cross reference to s. 634.345, F.S., which is repealed in

Section 8 of the bill. The bill creates new provisions relating to the cancellation of a contract and creates these provisions in s. 634.312, F.S.

**Section 7** creates s. 634.4062, F.S., relating to prohibited investments and loans. A service warranty association is prohibited from investing or lending association funds to any director, officer, or controlling stockholder. This prohibition applies only to an investment or loan reported by the respective association in its financial statements after the third quarterly financial statement of 2006. Currently, the laws governing warranty associations currently do not prohibit the respective associations from using association funds to secure the debts of or otherwise offer collateral for a security or debt instrument of officers of the association.

**Section 8** repeals s. 634.345, F.S., related to cancellation of a home warranty contract, because this issue is addressed in Section 5 of the bill.

**Section 9** provides that the bill will take effect July 1, 2006.

#### **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:

Since a service warranty association would be authorized to sell home warranties under the association's license for service warranties under certain circumstances, it would no longer be required to obtain licensure as a home warranty at a cost of \$200. According to the Office of Insurance Regulation, there are currently nine service warranty companies holding dual licensure as a home warranty and a service warranty association.

B. Private Sector Impact:

The bill would authorize a home warranty association to charge a consumer more to renew a home warranty than the current cost for a new warranty. Currently, the price to renew a home warranty may not be higher than the current cost for a new warranty. This change may result in a home warranty association charging more to a consumer for the renewal of a home warranty than the original cost to purchase the warranty, even if no additional appliances or other structures in the home will be covered. It is not possible to

estimate the impact of this change on consumers, however, since pricing for, and coverage under, home warranties vary.

The bill entitles purchasers of home warranties to cancel a warranty and receive partial refunds, as specified above.

**C. Government Sector Impact:**

The bill authorizes a service warranty association sell a warranty in connection with the sale of a home under the service warranty association's existing license, if certain conditions are met. According to OIR, there are nine warranty associations currently holding dual licenses as a service warranty and a home warranty. Since the bill eliminates the dual licensure requirement, the state may incur a loss of total revenue of approximately \$1,800 on annual basis.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

The OIR notes that the authority granted by the bill to home warranty associations to charge a consumer more to renew a home warranty than was charged to originally purchase the same warranty will be inconsistent with similar current law governing traditional insurance contracts. Under s. 626.9541, F.S., the law governing unfair methods of competition and unfair or deceptive acts, an insurer is prohibited from selling an identical or substantially similar product at different prices to customers of the same age and demographics, i.e., persons in the same actuarial class..

## **VIII. Summary of Amendments:**

None.

---

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

---