

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 649 CS

Home Warranty Associations

**SPONSOR(S):** Hasner

**TIED BILLS:**

**IDEN./SIM. BILLS:** SB 1620

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Committee	16 Y, 0 N, w/CS	Tinney	Cooper
2) Commerce Council	13 Y, 0 N	Tinney	Liepshutz
3) _____	_____	_____	_____
4) _____	_____	_____	_____
5) _____	_____	_____	_____

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### SUMMARY ANALYSIS

Chapter 634, F.S., regulates warranty associations, including motor vehicle service agreement companies, home warranty associations, and service warranty associations. A typical home warranty offers a homeowner protection for structural components of the home, appliances, and appliance systems. For example, a home warranty may cover kitchen and other household appliances. Additional coverage may be available for heating, ventilation, and air conditioning systems (HVAC); a pool or spa; exposed plumbing, e.g., toilets, sinks, spigots; roofs; and exposed electrical systems, e.g., ceiling fans, among other household furnishings and structures. The price of a 1-year home warranty typically varies in a range from \$250 to \$450, depending on the appliances and structural components covered, although the warranty may be renewed.

The regulation of warranty associations is assigned to the Office of Insurance Regulation (OIR), the state agency that also regulates insurers in Florida. OIR reports there are approximately 180 licenses issued to sell warranties in the state, although only 21 of the 180 are licenses for home warranty associations. In addition, an insurer authorized to sell property and casualty insurance in Florida, also may request a line of business authority to sell auto, home, and service warranties. OIR reports that an estimated 62 property and casualty insurers have an active line of business to sell home warranties.

The law regarding home warranty association forms and approval of forms by OIR is amended by the bill. Under the changes proposed by the bill, OIR is authorized to approve a form allowing the renewal of a home warranty more than nine times. The Office of Insurance Regulation also is authorized by the bill to approve a form providing a higher price to renew a warranty than the price to purchase a new warranty for the same home. The bill also specifies that if a home warranty association chooses to use a contractual liability insurance policy in lieu of establishing an unearned premium reserve, the contractual liability policy is required to cover all home warranty contracts issued during the policy period, regardless of whether the appropriate premium for all outstanding warranties has been paid to the issuer of the contractual liability policy.

The bill prohibits associations that issue home, automobile, and service warranties from making or securing loans from association funds for officers, directors, and shareholders. Current provisions regarding the cancellation of a home warranty are repealed and replaced with new, more detailed consumer protection requirements for cancellations and refunds associated with cancellations.

Under the bill, at the time a home sells, a service warranty association licensed under Part III of ch. 634, F.S., is authorized also to sell service warranties for homes, provided the warranties cover only systems and appliances, without warranting any structural component of the house. This means a service warranty association is authorized by the bill to sell service warranties, at the time a house is sold, under the association's license for service warranties, without seeking an additional license for home warranties.

There is no fiscal impact to OIR relating to the bill. Under the bill, homeowners who purchase a home warranty may be required to pay more to renew a warranty than the warranty would cost if purchased for the first time. Service warranty associations are authorized by the bill also to sell limited home warranties without seeking a separate home warranty association license from OIR; this will save service warranty associations the fee for a separate license.

**This document does not reflect the intent or official position of the bill sponsor or House of Representatives.**

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**DATE:** 3/9/2006

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

**Provide Limited Government:** Under the bill, a home warranty association will face fewer prohibitions on the sale and renewal of home warranties. A service warranty association is authorized by the bill to sell limited home warranties, at the time a house is sold, under its existing authority from OIR. This means a service warranty association may sell limited home warranties at the time a house is sold, in addition to service warranties, without paying the extra fee for a home warranty license.

**Promote Personal Responsibility:** Under the bill, OIR is no longer prohibited from approving forms that allow home warranty associations to charge more to renew a home warranty than the price to purchase the same warranty originally. Under current law, the price to renew a home warranty may not exceed the amount that would be charged if the contract were purchased on the same home for the first time.

#### B. EFFECT OF PROPOSED CHANGES:

##### Background

Chapter 634, F.S., 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 typical home warranty offers a homeowner protection for structural components or kitchen and other household appliances. Additional coverage may be available for heating, ventilation, and air conditioning systems (HVAC); a pool or spa; exposed plumbing, e.g., toilets, sinks, spigots; roofs; and exposed electrical systems, e.g., ceiling fans, among other household furnishings and structures. The price of a 1-year home warranty typically varies in a range from \$250 to \$450, depending on the appliances and structures covered, although the warranty may be renewed.

A home warranty generally is offered in tandem 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.

The regulation of warranty associations is assigned to the Office of Insurance Regulation (OIR), the state agency that also regulates insurers in Florida. Although a warranty generally is not thought of as a traditional insurance product, such warranties protect policyholders from certain future risks, as specified in the contract, and associated costs.

As a result of indemnifying a warranty holder from future misfortune, a warranty association is, in effect, protecting the warranty holder from specified future risks, for a specified time period. Because warranty associations indemnify warranty holders from risk or loss associated with either a future structural defect in a home or with the appliances in the home, OIR is directed by law to regulate warranty

associations, including approval of forms, complaint investigation, and monitoring reserve requirements, among other duties. OIR is not required to approve rates for warranties, however.

The Office of Insurance Regulation reports that there are approximately 180 licenses issued to sell warranties in the state, although only 21 of the 180 are for home warranty associations. In addition, an insurer authorized to sell property and casualty insurance in Florida, also may request a line of business authority to sell auto, home, and service warranties. OIR reports that an estimated 62 property and casualty insurers have an active line of business to sell home warranties.

In Florida, an estimated 40 licensed warranty associations have formed a trade association, the Florida Service Agreement Association; the association was originally formed in 1989.<sup>1</sup> Representatives of the association report that association members meet annually. Members of the state warranty association include insurers, independent warranty administrators, retailers, auto dealers, air conditioning contractors, and manufacturers, most of which offer warranties in addition to their core business.<sup>2</sup>

A warranty association may employ repair persons who actually repair covered appliances and structures, although an association also may contract for repair services. Terms of warranties vary; for example, in some cases a warranty holder/homeowner may be required to make a co-payment at the time a repair is made. Other warranties may only require an annual premium, without a co-payment, if a repair person is called to the home.

### **Current Law and Changes Proposed by the Bill**

Laws governing auto warranty, home warranty, and service warranty associations specify the types and amounts of liquid reserves the various associations must maintain to ensure solvency for settling customer claims. The laws governing the three types of 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. Under the bill, a home warranty, auto warranty, and service warranty association all are prohibited from securing debts of an association director, officer, or controlling stockholder using association monies. 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.

Current statutory definitions relating to home warranty associations are amended by the bill.<sup>3</sup> Under the bill, the definition for "home warranty" is amended to allow a service warranty association also to issue a service warranty at the time a home is sold if the warranty covers only appliances and systems within the home, but does not cover any structural components of the home, e.g., roof, walls, or foundation. This means a service warranty association may sell warranties, at the time a home is sold, for appliances and home systems, e.g., heating and air conditioning, under its service warranty license, rather than applying for a separate home warranty license, as well.

Current law specifying the reserve requirements for a home warranty association is amended by the bill.<sup>4</sup> In current law, one method for providing the unearned premium reserve required of a home warranty association is through the purchase of contractual liability insurance.<sup>5</sup> Under the bill, a contractual liability policy purchased by a home warranty association is required to insure all warranty contracts in effect during the term of the liability policy, even if the warranty association fails to remit the full premium to the insurer.

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<sup>1</sup> Personal Communication with the Executive Director of the Florida Service Agreement Association, dated February 3, 2006; on file with Insurance Committee.

<sup>2</sup> *Id.*

<sup>3</sup> See s. 634.401, F.S., 2005, for definitions pertaining to home warranty associations.

<sup>4</sup> Section 634.3077, F.S., 2005, outlines the financial requirements, i.e., the reserve requirements, for a home warranty association.

<sup>5</sup> See s. 634.3077(3), F.S., 2005.

The law requires a home warranty association to file its application and other similar forms with OIR for approval.<sup>6</sup> Current law requires OIR to disapprove a home warranty association form if the form allows for more than nine annual renewals.<sup>7</sup> Similarly, OIR may not approve 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.<sup>8</sup> The law also prohibits a home warranty association from charging a fee to inspect the premises to be covered by the warranty.<sup>9</sup>

The law regarding home warranty association forms and approval of forms by OIR is amended by the bill. Under the changes proposed by the bill, OIR is authorized to approve a form to allow the renewal of a home warranty more than nine times. The bill also authorizes OIR to approve a form providing a higher price to renew a warranty than the price to purchase a new warranty for the same house. The bill does not authorize a home warranty association to charge an inspection fee before selling or renewing a home warranty.

New provisions are added by the bill regarding cancellation of a home warranty either by the warranty holder or the warranty association. As a result of the new provisions, current law at s. 634.345, F.S., is repealed by the bill. A cross-reference to the law repealed by the bill also is deleted.

A home warranty contract is required by the bill to outline the association's cancellation policy. Under the bill, a purchaser may cancel a home warranty within 10 days after the purchase and receive a full refund of gross premium paid, less any claims paid during the first 10 days. An association may withhold an administrative fee, not to exceed 5 percent of the gross premium paid, for a cancellation made within 10 days of purchasing the home warranty.

If a warranty holder cancels his or her home warranty after 10 days, the association is required by the bill to refund the purchaser at least 90 percent of the unearned, pro rata premium, less any claims that have been paid. 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 purchaser, the association must refund all the unearned pro rata premium to the purchaser.

#### C. SECTION DIRECTORY:

**Section 1** creates s. 634.042, F.S., to prohibit specified investments and loans by motor vehicle service agreement companies.

**Section 2** amends definitions in s. 634.301, F.S., relating to home warranty associations.

**Section 3** creates s. 634.3076, F.S., to prohibit specified investments and loans by home warranty associations.

**Section 4** amends s. 634.3077, F.S., relating to contractual liability policy requirements for home warranty associations.

**Section 5** amends s. 634.312, F.S., relating to the forms a home warranty association must submit to OIR for approval.

**Section 6** amends s. 634.336, F.S., to delete an obsolete cross-reference.

**Section 7** creates s. 634.4062, F.S., to prohibit specified investments and loans by service warranty associations.

**Section 8** repeals s. 634.345, F.S., because similar provisions are addressed elsewhere by the bill.

**Section 9** provides an effective date of July 1, 2006 for the bill.

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<sup>6</sup> Section 634.312, F.S., 2005.

<sup>7</sup> Section 634.312(3), F.S., 2005.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

#### 1. Revenues:

Under the bill, a service warranty association is authorized to sell limited service warranties at the time a home is sold. A service warranty association no longer is required to obtain a separate a home warranty association license from OIR before selling a service warranty at the time a home is sold.

#### 2. Expenditures:

None.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

#### 1. Revenues:

None.

#### 2. Expenditures:

None.

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The Office of Insurance Regulation notes in its analysis of the bill that, under the changes in the bill (lines 117 and 118), a home warranty association will be authorized to charge a consumer who seeks to renew a home warranty more than the cost of a new warranty for the same home.<sup>10</sup> Current law prohibits a warranty association from charging a consumer more to renew a home warranty than the cost for the same warranty at the time a house is sold.

This change may result in home warranty associations charging more to a consumer for the renewal of a home warranty than the cost to purchase the warranty on the same home for the first time, 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 coverages under, home warranties vary.

The bill authorizes an existing service warranty association also to sell limited service warranties under the service warranty association's existing license, at the time a home is sold. According to OIR, this means that each of the nine warranty associations currently holding licenses to issue both service warranties and home warranties could save \$200 each year.

### D. FISCAL COMMENTS:

None.

## III. COMMENTS

### A. CONSTITUTIONAL ISSUES:

#### 1. Applicability of Municipality/County Mandates Provision:

None.

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<sup>10</sup> Legislative Bill Analysis from OIR; dated January 30, 2006.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

OIR notes that the elimination of the prohibition against approval of forms to charge a consumer more to renew a home warranty than the cost to purchase a new warranty of the same home for the first time, 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.<sup>11</sup>

#### **IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**

At the February 7, 2006 meeting of the House Insurance Committee, the committee adopted an amendment to HB 649. The amendment made the following changes to the original bill:

- Prohibits associations that issue home, automobile, and service warranties from making or securing loans from association funds for officers, directors, and shareholders.
- Specifies conditions under which a home warranty agreement may be cancelled by the purchaser or issuer and specifies refund amounts due following cancellation. (Repeals current law and moves the new provisions regarding home warranty cancellation to a new section of law.)
- Requires a contractual liability insurance policy to pay home warranty customer claims made during the term of the policy, regardless of whether the warranty association has remitted the full premium to the insurer.
- Allows a service warranty association licensed under Part III of ch. 634, F.S., to sell service warranties at the time a house is sold, provided the warranties cover only systems and appliances, without warranting any structural component of the house. This means a service warranty association is authorized to sell limited warranties, at the time the house is sold, under the service warranty association license, without seeking an additional license for home warranties.

This analysis has been updated to reflect the amendment adopted by the Insurance Committee 2/7/06.

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<sup>11</sup> See s. 626.9541(1)(g), F.S., 2005.  
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