

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: SPB 7098

INTRODUCER: For consideration by Banking and Insurance Committee

SUBJECT: Florida Workers' Compensation Joint Underwriting Association

DATE: February 1, 2006

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh		Pre-meeting
2.				
3.				
4.				
5.				
6.				

I. Summary:

The bill incorporates legislative recommendations relating to the Florida Workers' Compensation Joint Underwriting Association (JUA) that were included in the 2006 Senate Banking and Insurance Committee staff interim report entitled, *Florida's Workers' Compensation Insurance Rating System*.¹ The bill amends laws governing the JUA to provide greater accountability and oversight, to authorize additional funding mechanisms, and to require prior approval of rates:

- The board membership is expanded from nine to eleven members by increasing the number of appointees by the Financial Services Commission (FSC) from three to five members. The insurance industry would continue to appoint five members; the number of state government appointees would increase from four to six members (including the Consumer Advocate of the Department of Financial Services).
- The JUA is required to use any policyholder surplus attributable to former subplan C prior to requesting funding from the State or assessing policyholders in the voluntary market for funding deficits in former subplan D, Tiers One, and Tiers Two.
- Access to funds in the contingency reserve for funding deficits in subplan D is extended from January 1, 2007, to January 1, 2011.
- The deadline for levying "below-the-line" assessments to fund deficits in subplan D, Tier One, and Tier Two is extended from July 1, 2007, to July 1, 2008.
- The JUA is required to return any state funds in excess of the amount necessary to fund deficits in former subplan D or any tier.

¹ Senate Banking and Insurance Committee Interim Report 2006-101.

- The JUA is required to obtain prior approval of its rates by the Office of Insurance Regulation before implementing the rates.

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

II. Present Situation:

Prior to the creation of the Florida Workers' Compensation Underwriting Association (JUA) in 1993, the Florida Workers' Compensation Insurance Plan (FWCIP) was the residual market or insurer of last resort, for workers' compensation insurance coverage. The FWCIP administered by the National Council on Compensation Insurance (NCCI), provided workers' compensation insurance to employers who were required by law to maintain coverage and who were unable to purchase such insurance through the voluntary market. Deficits in the FWCIP were funded by assessments on carriers writing such coverage in the voluntary market based on their market share in the voluntary market.

In 1993, the Legislature eliminated the FWCIP and created the current JUA as a nonprofit, self-funding entity, governed by a nine-member board, to act as a residual market.² The board is comprised of three members appointed by the Financial Services Commission (FSC); two members representing the top 20 domestic insurers writing workers' compensation; two members representing the top 20 foreign insurers writing workers' compensation; 1 person appointed by the largest property and casualty insurance agents' association; and the Consumer Advocate for the Department of Financial Services.

The JUA is authorized to establish and use its rates 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 Office of Insurance Regulation (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.³ The standard for approving insurance rates in Florida is that the rate may not be excessive, inadequate, or unfairly discriminatory.⁴

2003 JUA Legislation

In 2003 and 2004, the Legislature addressed concerns regarding affordability and availability of workers' compensation insurance for small employers in the JUA. In 2003, the Legislature established subplan D in the JUA to provide coverage for generally small employers (15 or fewer employees).⁵ Although rates in this subplan were capped at 25 percent over the voluntary market rates, the policies were subject to assessments for additional premiums to cover any deficit 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

² Section 627.311(5), F.S.

³ Section 627.101(2), F.S.

⁴ Sections 627.062(1) and 627.151, F.S.

⁵ The law also provided coverage for certain charitable organizations that was capped at 10 percent over the voluntary market rates.

subplan D would likely incur a deficit. As of December 31, 2003, the JUA reported a \$9.9 million deficit. In February 2004, there were approximately 2,500 policyholders in subplan D.

2004 JUA Legislation

In 2004, the Legislature enacted changes to the JUA law to address the growing deficit in subplan D and provide affordable coverage for small employers that are unable to obtain coverage in the voluntary market.⁶ The law provided a one-time appropriation of \$10 million from the Workers' Compensation Administration 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 the WCATF to cover any remaining subplan D deficit, subject to approval by the Legislative Budget Commission. The Governor subsequently vetoed the \$10 million appropriation to the JUA.

The law also restructured the JUA by eliminating subplans A, B, C, and D and creating three tiers with eligibility based on an employer's loss experience, effective July 1, 2004.⁷ Premiums in Tier One and Two are capped 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. Tier Three rates are required to be actuarially sound and these policies are subject to assessments for additional premiums to cover any deficit.

Any deficits in Tiers One, Tier Two, or any deficit remaining from any of the former subplans can be funded by a "below-the-line" assessment on workers' compensation policies in the voluntary market until July 1, 2007. Policyholders in the voluntary market and nongovernmental self-insurance funds are subject to the assessment. The JUA may request funding through the Legislative Budget Commission for any deficit in Tier Three in the event assessments on Tier Three policyholders are inadequate to fund such a deficit. Former subplan D policyholders are not subject to assessments for the funding of any deficits.

Oversight and Regulation of the JUA

The JUA, as a residual market mechanism, is exempt from many provisions of the Insurance Code that are applicable to insurers in the voluntary market, such as surplus and solvency requirements. However, the JUA and the other residual markets are subject to market conduct examinations pursuant to the OIR's authority under s. 624.3161, F.S., to determine whether the entity is complying with applicable provisions of the Insurance Code and the Workers' Compensation Law. In addition, the JUA's plan of operation and any changes to the plan are subject to the approval of the OIR pursuant to s. 627.311, F.S.

⁶ Chapter 2004-266, L.O.F.

⁷ Tier One 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. Tier Two 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 Three provides coverage for all other employers.

The Office of Insurance Regulation noted that the JUA premiums are consistently higher than residual markets or JUA's in other states. The rates in Tier Three policies are currently set at 170 percent above the voluntary market rate.⁸ In contrast, the OIR noted that residual markets in 21 other states charge rates with an average differential of 35 percent above the voluntary market rate.⁹ In its *2004 Workers' Compensation Annual Report*, the OIR noted that the capped rates for Tiers One and Two expire on January 1, 2007, and then the rates are required to be actuarially sound. Since the ability to levy below-the-line assessments for Tiers One and Two expires on July 1, 2007, there will no funding mechanism for deficits in Tiers One and Two. The report notes that this will undoubtedly result in the use of very conservative actuarial assumptions to prevent deficits, which can only mean higher rates. The OIR recommends that the Legislature extend or eliminate the July 1, 2007 expiration date of the below-the-line assessments for Tiers One and Two in order to keep these rates at a more reasonable level.

Due to concerns regarding the accountability of the JUA, the Legislature directed the Auditor General to perform an operational audit of the JUA.¹⁰ In 2004, the Auditor General released the audit report, which included findings and recommendations regarding the administration, rates, and funding of the JUA.¹¹ The Auditor General's contracted actuary concluded, among other findings, that: required reserves of the JUA should be significantly less than the JUA actuary's best estimate of required reserves and the JUA could have established a lower rate for Tier Three policies. The Auditor General recommended that the Legislature consider enacting legislation that expedites the requirement that rates for Tiers One and Two be determined on an actuarially sound basis. The report also recommended that the Legislature consider enacting legislation addressing the use of surplus funds attributable to other subplans, such as subplan C, to fund the deficit in subplan D.

Through legislative action, the report noted that it might be possible to reduce the JUA's costs by making the JUA exempt from federal taxation. The report recommended that the Legislature consider enacting legislation to qualify the JUA as a tax-exempt organization under s. 501(c) of the Internal Revenue Code. Currently, Citizens and the Florida Automobile Joint Underwriting Association qualify as tax-exempt organizations.

Funding Deficits in the JUA

According to the most 2005 third quarter statements, the JUA recognized an overall deficit of \$14,788,767. The JUA quarterly filing to the OIR provided the following breakout by subplan and tier:

⁸ Preferred Insurance Capital Consultants, LLC, *Actuarial Review of the Florida Workers' Compensation Joint Underwriting Association*, November 22, 2004.

⁹ Office of Insurance Regulation, *2004 Workers' Compensation Annual Report* (2005).

¹⁰ Chapter 2004-266, L.O.F.

¹¹ Auditor General, State of Florida, *Operational Audit of the Florida Workers' Compensation Joint Underwriting Association, Inc.* (2004).

Subplan/Tier	2005 Total Surplus/(Deficit)
A, B, and C	\$15,600,562
D	(\$18,578,981)
1	(\$1,467,891)
2	(\$6,556,680)
3	(\$3,785,777)

On June 30, 2004, the JUA ceased writing policies in subplans A, B, C, D when these subplans were eliminated and Tiers One, Two, and Three were created, effective July 1, 2004. The JUA's plan to eliminate the deficit in subplan D contemplates the use of the remaining \$7 million out of the \$15 million contingency reserve and the collection of a "below-the-line assessment" of \$4.77 million in order to extinguish the subplan D deficit by June 2007. As of August 2005, the JUA has received approximately \$7.9 million in funds transferred from the Workers' Compensation Administrative Trust Fund. However, access to the contingency reserve is eliminated, effective January 1, 2007. It is anticipated that the JUA will be unable to access all of these funds, on a cash flow basis, by that date.

Without legislative action, the only currently available source of additional funding is the below-the-line assessment. Individual, self-insured employers and governmental self-insurance funds are not subject to the assessment. The JUA contemplates collecting the assessment in 12 equal installments, effective July 31, 2006.¹² To fund the deficit, an estimated assessment in the range of 0.1 - 0.2 percent would be required on every policy in the voluntary market.

The elimination of the deficit in Tier Three relies upon the deficit being eliminated by increasing rates. At the JUA's September 20, 2005 meeting, the board considered a recommendation to increase the average premium level of Tier Three by 2 percent, based upon the current voluntary market rate levels, effective January 1, 2007. The board of the JUA also discussed the option of eliminating deficits in Tiers One and Two by increasing the premiums in these tiers on January 1, 2007, when the rate caps are eliminated. The board also noted that the current law provides for a "below-the-line" assessment to fund such deficits. The JUA board reviewed analysis from their actuary that indicated a need for a premium level increase of 35.4% for Tier 1 and 32.3% for Tier 2 based upon current voluntary market rates.

The JUA believes that the rates in effect for former subplans A, B, and C were actuarially sound and the loss reserves carried through 2004 make a reasonable provision for all unpaid loss obligations of those subplans. The surplus balance in former subplan C is approximately \$15 million. Subplans B and C issued assessable policies. The JUA states that no policyholder assessments will be required for these subplans.¹³ Currently, the operation manual of the JUA prohibits the use of surplus funds related to other subplans to fund the subplan D deficit. However, the statutes do not clearly address this issue.

¹² Letter from Milliman Consultants and Actuaries to Laura Torrence, Executive Director of the JUA, dated September 7, 2005.

¹³ 2004 Management's Discussion and Analysis, Florida Workers Compensation Joint Underwriting Association filed with the OIR April 1, 2005.

Applicability of the “Government-in-the-Sunshine Law”

Florida’s Government-in-the-Sunshine Law (The Sunshine Law) provides a right of access to governmental records and proceedings at both the state and local governmental levels. Historically, this law has been held to apply to private entities created by law or by public agencies, unless specifically exempted by law. Section 119.01, F.S., the public records laws, requires that records made or received in connection with the transaction of official business by an agency must be open for inspection in the absence of a statute exempting the record or making it confidential. The law defines the term, “agency,” to include any authority, board, commission, or other separate unit of government, *created or established by law* and any other public or private agency, person, partnership, corporation, or business entity, acting on behalf of any public agency.¹⁴ Section 286.011, F.S., relating to public meetings and records provides that all meetings of any board of any state agency or authority at which official acts are to be taken are open to the public unless exempted.

Citizens Property Insurance Corporation, the Florida Automobile Joint Underwriting Association, and the Florida Medical Malpractice Joint Underwriting Association, which operate as residual markets, have public record exemptions created in law. These exemptions include portions of meetings and claims and underwriting records related to ongoing litigation. This type of exemption assists residual markets during the litigation of a claim, since the release of such information could jeopardize or compromise ongoing or pending litigation. Presently, the JUA does not have statutory exemptions from the Sunshine Law.

Section 627.311(5)(b), F.S., provides that the minutes, audits, and procedures of the JUA board are subject to ch. 119, F.S. In recent years, representatives of the JUA have contended that the JUA is not statutorily subject to the “Government-in-the-Sunshine” provisions; however, the JUA “has agreed to conduct its meetings in the spirit of those requirements pursuant to regulatory requests.”¹⁵ The Office of the Attorney General has opined that joint underwriting associations, such as the former Florida Windstorm Underwriting Association and the Residential Property and Casualty Joint Underwriting Association are subject to Public Records Law. The Attorney General’s Office has opined that residual markets are considered “agencies” as defined in chapter 119, F.S., and are accordingly, subject to the provisions of the Government-in-the-Sunshine Law, unless specifically exempted from the provisions.¹⁶ Recently, the Office of Insurance Regulation directed the JUA to amend its plan of operations to provide for meetings noticed in accordance with the Sunshine Laws and to comply promptly with all public record requests unless the information is exempt from the public record laws.¹⁷

Senate Banking and Insurance Interim Report Recommendations

The interim report provided the following legislative recommendations to address funding, availability, affordability, accountability issues relating to the JUA:

¹⁴ Section 119.011(2), F.S.

¹⁵ Florida Workers’ Compensation Joint Underwriting Association, Inc. Minutes of the Board of Governors Meeting, June 22, 2005.

¹⁶ AGO 94-32 and AGO 95-32.

¹⁷ Letter from Kevin M. McCarty, Commissioner of the OIR to Laura Torrence, Executive Director of the JUA, dated October 12, 2005.

- Authorize the JUA to use some of the estimated \$15 million surplus funds attributable to former subplan C to mitigate the estimated \$4.77 million deficit in subplan D and any deficits in Tiers One and Two that are a result of the capped rates. The capped rates in Tiers One and Two are eliminated by January 1, 2007.
- Exclude former policyholders of subplan C from any potential assessments to prevent these former policyholders from incurring any potential liability in the event the JUA's estimated surplus in these plans adversely changes.
- Consider extending the current expiration date of January 1, 2007, for accessing the \$15 million contingency reserve to allow the JUA to use any remaining funds beyond the deadline to fund the subplan D deficit.
- Consider extending or eliminating the July 1, 2007 expiration date for the below-the-line assessments for Tiers One and Two in order to keep these rates at a more reasonable level. As an alternative to extending the below-the-line assessment, the Legislature should consider providing funding from the Workers' Compensation Administrative Trust Fund through the current Legislative Budget Commission process to cover deficits attributable to capped rates in Tiers One and Two.
- Require the JUA to obtain approval of its rates prior to using the rates, as is currently required of the voluntary market insurers, to ensure that the rates are not excessive, inadequate, or unfairly discriminatory, subject to statutory requirements regarding capped rates.
- Require the JUA to return any unused state funds allocated for funding subplan D deficit to the State of Florida.
- Consider enacting legislation to assist the JUA in meeting criteria to qualify as a tax-exempt organization under s. 501(c) of the Internal Revenue Code, such as changing the board composition of the JUA so that the state appoints a majority of the board members.
- Create public records and meetings exemption for the JUA that are comparable to the exemptions provided to other JUAs. This type of exemption, which currently exists for many other residual markets, aids residual markets during the litigation of a claim since the release of such information could jeopardize or compromise ongoing or pending litigation.

III. Effect of Proposed Changes:

Section 1 This section amends s. 627.311, F.S. The total number of members on the board of the Florida Workers' Compensation Joint Underwriting Association (JUA) is increased from nine to eleven by increasing the number of members appointed by the Financial Services Commission 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 Financial Services Commission may remove any member for cause.

The bill clarifies that the meeting minutes, audits, and procedures 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 JUA is required to fund any deficits in subplan D, Tiers One, and Tier Two by using policyholder surplus attributable to former subplan C, or if the surplus in subplan C does not fully fund the deficit, the JUA may request accessing any remaining funds in the contingency reserve. Currently, the funding mechanisms for subplan D are the contingency reserve first, and then, assessments on policyholders in the voluntary market, if the contingency reserve cannot fully fund the deficit. Current law provides funding for deficits in Tiers One and Two through assessments on policyholders in the voluntary market until July 1, 2007.

Deficit funding for Tier Three continues to be initially provided through assessments on policyholders in Tier Three. The JUA would fund any remaining deficit by requesting the transfer of funds from the Workers Compensation Administration Trust Fund, subject to the approval of the Legislative Budget Commission (LBC). The LBC would evaluate such requests for funds based on the cash flow needs of the JUA on a 6-months basis, rather than the current 3-month basis.

The section also provides that policyholders in former subplan C are not subject to any assessments attributable to deficits in subplan D and Tiers One, Two, and Three.

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.

The bill requires the JUA to return any state funds in excess of the amount necessary to fund a deficit in subplan "D" or any tier.

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

Section 2 revises section 2 of chapter 2004-266, L.O.F., appearing as a footnote to s. 627.311, F.S., to allow the JUA to evaluate cash flow needs for funding the subplan D deficit on a 6-month basis rather than the current 3-month basis for accessing the contingency reserve established to fund the deficit. The Workers' Compensation Administration Trust Fund provides funding for the contingency reserve. The section requires the JUA to determine cash flow needs for subplan D after accessing any available policyholder surplus attributable to subplan C. The section extends the deadline for accessing funds from the contingency reserve from January 1, 2007, to January 1, 2011.

Section 3 provides that this act shall 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:

Without legislative action to provide additional funding to the JUA beyond January 1, 2007, the JUA will find it necessary to levy a “below-the-line” assessment on policyholders in the voluntary market. To fund the deficit, an estimated assessment in the range of 0.1 - 0.2 percent would be required on every policy in the voluntary market subject to the assessment. Individual, self-insured employers and governmental self-insurance funds are not subject to the assessment. The JUA contemplates collecting the assessment in 12 equal installments, effective July 31, 2006.¹⁸

Contingent upon the future financial condition of the Florida Workers’ Compensation Joint Underwriting Association (JUA), the receipt of state funds could generate federal income tax liability for the JUA, thereby reducing the ultimate amount of such funds available to the JUA.

Once legislative changes related to the organization and operations of the JUA are enacted and the JUA is able to receive a tax ruling or determination from the Internal Revenue Service that it qualifies as a 501(c) tax-exempt organization, the JUA would be eligible to be exempt from federal income tax.

B. Private Sector Impact:

Policyholders in the JUA may benefit from the change in rate approval process since the rates will be subject to prior approval by the Office of Insurance Regulation. Since the 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., which provides that rates not be inadequate, excessive, or discriminatory.

C. Government Sector Impact:

If the JUA is required to use the estimated \$15 million of policyholder surplus attributable to former subplan C before accessing the contingency reserve, the State of Florida will be able to reduce the amount of state funding provided to the JUA. If the surplus in subplan C is not used, and in order to prevent assessments on policyholders, it is estimated that the state would be required to appropriate at least \$12-13 million (the

¹⁸ Letter from Milliman Consultants and Actuaries to Laura Torrence, Executive Director of the JUA, dated September 7, 2005.

estimated \$7 million remaining in the contingency reserve and an additional \$5-6 million to fund deficits in former subplan D, Tier One, and Tier Two). Additional funding might be required to address deficits in Tiers One and Two. If the surplus in subplan C is inadequate to fund deficits, the bill extends the time to access the state contingency reserve from July 1, 2007 to July 1, 2011. The total amount of deficits, as of December 31, 2005, is indeterminate at this time, since the JUA has not completed the audited financial statements and the annual statement for 2005. The JUA is required to file the annual statement and the audited financial statements with the Office of Financial Regulation on or before March 1 and June 1 for the preceding year, respectively.

VI. Technical Deficiencies:

Additional statutory changes in the laws governing the JUA will be necessary to address IRS section 501(c) tax-exempt requirements. Certain organizational and operational requirements, such as the use of assets and the distribution of assets upon dissolution, must be addressed. The JUA has engaged a tax consultant to provide recommendations.

VII. Related Issues:

To provide additional funding mechanisms for financing deficits in the JUA, access to the contingency reserve could be further extended and the ability to levy a “below-the-assessment “ on policyholders in the voluntary market could also be extended. These funding mechanisms could only be used after the available policyholder surplus in former subplan C had been accessed.

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.
