

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1267 Property Insurance
SPONSOR(S): Jobs & Entrepreneurship Council; Robaina and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 2498

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Committee on Insurance</u>	<u>(ref. removed)</u>	<u></u>	<u></u>
2) <u>Jobs & Entrepreneurship Council</u>	<u>12 Y, 2 N, As CS</u>	<u>Callaway</u>	<u>Thorn</u>
3) <u>Policy & Budget Council</u>	<u></u>	<u>Martin</u>	<u>Hansen</u>
4) <u></u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

SUMMARY ANALYSIS

This bill makes changes to the Citizens Property Insurance Corporation ("Citizens") law, prohibits the formation of Florida domestic residential property insurance subsidiaries ("pup companies"), and requires rate filings for insurance subsidiaries to include parent company profit information. Specifically, the bill:

- Revises Citizens' legislative intent language emphasizing the need for affordable property insurance to be provided by Citizens;
- Provides that if a *new* applicant to Citizens is offered coverage from an insurer at its approved rate, the applicant is not eligible for a Citizens policy unless the insurer's premium is more than 15 percent greater than the premium for comparable Citizens' coverage (current law has a 25 percent limitation);
- Freezes Citizens' rates until January 1, 2009 (current law freezes the rates until January 1, 2008).
- Provides that effective January 1, 2008, the following provisions apply to "pup companies":
 - A new certificate of authority may not be issued to a Florida domestic residential property insurer that is a wholly owned subsidiary of an insurer authorized to conduct business in another state ("pup company"); and,
 - The rate filings of any Florida domestic insurer that is a wholly owned subsidiary of an insurer authorized to do business in another state ("pup company") shall include information relating to the profits of the parent company of the Florida domestic insurer.

Although the bill has no direct fiscal impact on the state, it does significantly increase the potential moral obligation of the state to cover Citizens' losses should there occur another hurricane season comparable to the 2004 and 2005 storms. By freezing the rates for an additional year until January 1, 2009, Citizens inability to set actuarially sound rates that will build reserves to cover losses will be exacerbated. In addition, the effect of House Bill 1A,¹ enacted during the 2007 Special Session, which increased the potential loss exposure of Citizens by expanding market share and adding more clients compounds this problem.

This bill is effective upon becoming a law unless otherwise expressly provided in the bill.

¹ Chapter 2007-1, L.O.F.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Provide Limited Government, Safeguard Individual Liberty: The bill provides new regulations for insurance companies including the prohibition on new pup companies and the consideration of parent insurer profits in a pup company's rate filing. The bill loosens current law relating to eligibility for property insurance in Citizens Property Insurance Corporation (Citizens) and freezes Citizens' rates until January 1, 2009.

B. EFFECT OF PROPOSED CHANGES:

Citizens Property Insurance Corporation ("Citizens")

In 2002, the Florida Legislature created Citizens by combining the state's two insurers of last resort, the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA).² The merger allowed Citizens to become exempt from federal income taxes, resulting in millions of dollars in annual savings, as well as additional administrative and economic efficiencies.

Since that time, Citizens has become the largest property insurer in the State. As of February 28, 2007, Citizens provided coverage to over 1.3 million policyholders with \$432 billion in exposure and a market share of approximately 22 percent based on the number of policies in force.

Citizens' offers three types of property and casualty insurance in three separate accounts:

- Personal Lines Account (PLA) which offers multi-peril policies covering homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners and similar policies;
- Commercial Lines Account (CLA) which offers multi-peril policies covering commercial residential (condominium associations, apartment buildings, homeowners associations) and commercial nonresidential (business); and
- High-Risk Account (HRA) which covers multi-peril policies or wind-only policies, or both, for personal residential and commercial (residential and non-residential) policyholders.³

The number of policyholders in the three accounts are: PLA = 805,327; CLA = 10,255, and HRA = 407,681.⁴

Expanded Eligibility for Residential Coverage from Citizens

House Bill 1A,⁵ enacted during the 2007 Special Session, expanded eligibility for coverage in Citizens by placing Citizens in more direct competition with the voluntary market by substantially revising the law that made a property ineligible for coverage from Citizens if an offer of coverage was made by an authorized insurer at the authorized insurers' approved rates. Under HB 1A, if a *new applicant* to Citizens is offered coverage from an insurer at its approved rate, the applicant is *not eligible* for a Citizens' policy, unless the insurer's premium is more than 25 percent greater than the premium for comparable coverage from Citizens. However, a *policyholder* of Citizens remains eligible for coverage regardless of any offer of coverage from a private market insurer. This allows a policyholder to choose to stay in Citizens and to reject any "take-out" offers from the voluntary market. But, the voluntary market may continue to "keep out" policies from Citizens, provided the premium is no more than 25 percent greater than Citizens' premium. As a result of this change and the rating law provisions

² Chapter 2002-240, L.O.F.

³ Legislation enacted during the 2007 Special Session (ch. 2007-1, L.O.F.) authorized Citizens to offer multi-peril coverage in its HRA.

⁴ <http://www.citizensfla.com/> (last viewed April 10, 2007).

⁵ Chapter 2007-1, L.O.F.

related to Citizens contained in HB 1A, Citizens is now in a more competitive role with the private market, with increasing numbers of policyholders potentially eligible for coverage with Citizens. These changes make it likely to increase its policy growth at an even greater pace, at least for the near future.

Rates for Coverage from Citizens

HB 1A substantially revised the requirements, standards, and procedures for establishing rates for Citizens' policies in an attempt to provide immediate rate relief to Citizens' policyholders while establishing a long term rate standard based on actuarial soundness, rather than focusing on non-competitiveness or collecting sufficient premium to have reserves and reinsurance to cover a specified probable maximum loss. The changes required that Citizens' rates be actuarially sound and subject to s. 627.062, F.S., which prohibits rates that are excessive, inadequate, or unfairly discriminatory, and specifies factors for the Office of Insurance Regulation (OIR) to consider in making this determination. The bill retained the requirement that after the public hurricane loss model has been found to be accurate and reliable by the Florida Commission on Hurricane Loss Projection Methodology, that model shall serve as the minimum benchmark for determining Citizens' windstorm rates.

HB 1A required Citizens to make a new rate filing, using the actuarially sound rate standard, effective January 1, 2008. Although the term "actuarially sound" does not have a precise definition, particularly when applied to a residual market insurer that depends on assessments for financing, the term generally means a rate that will cover expected losses. When applied to windstorm losses, this means a rate sufficient to cover average annual expected losses, based on hurricane loss projection models. The OIR will determine whether the rate filed by Citizens is "actuarially sound" and will determine what components Citizens is allowed to include in its "actuarially sound" rates.⁶

HB 1A required the OIR to annually establish Citizens' rates within 45 days after Citizens files recommended rates, and prohibited Citizens from legally challenging the OIR determination. In addition, for one year (2007), HB 1A froze Citizens' rates to those that were in effect on December 31, 2006, resulting in immediate premium reductions for Citizens' policyholders. During the one year rate freeze, Citizens is still able to make rate filings which reduces rates further during the year; they are just not allowed to increase rates.

Effect of Proposed Changes

The bill amends s. 627.351, F.S., relating to the Citizens Property Insurance Corporation ("Citizens") law. The bill modifies the original Legislative "intent" language in the law which authorized the creation of Citizens in 2002.⁷ The bill makes Legislative findings which emphasize the lack of affordable property insurance in the state; that private insurers are unwilling or unable to provide such affordable coverage which threatens the public health, safety and welfare and the economic health of Florida; that there is a compelling public interest that property be insured at affordable rates to facilitate rehabilitation of damaged or destroyed property; that Citizens provide such affordable property insurance because it is not devoted to private profit making pursuits and is organized to achieve efficiencies and economies, while servicing policyholders, which equals or exceeds the quality provided in the voluntary market; that Citizens serve to increase the availability of affordable property insurance and offer the lowest rates possible consistent with sound business practices. The bill retains the current intent language which provides that it is essential for Citizens to have financial resources to pay claims and that it is the Legislature's intent that Citizens' income be exempt from federal income taxation.

⁶ It unclear whether any additional amount beyond average annual loss should be included in Citizens' rate to collect an imputed "cost of capital" that would reduce Citizens' reliance on assessments. It is also not clear if the term "actuarially sound" encompasses charging an amount in excess of annual average loss to build towards financing a probable maximum loss for a specified period, such as a 50 or 100 year storm. (Even though Citizens would be subject to a rate standard substantially the same as for voluntary market property insurers, Citizens is not subject to the same solvency requirements such as minimum surplus, restrictions on premium writings, or having surplus and reinsurance to cover a 100-year probable maximum loss.)

⁷ Chapter 2002-240, L.O.F.

The bill revises the provision adopted in HB 1A as to *new* applicants for Citizens' coverage. The bill states that if a new applicant is offered coverage from an insurer at its approved rate, the applicant is not eligible for a Citizens' policy, unless the insurer's premium is more than 15 percent greater than the premium for comparable coverage from Citizens. Under HB 1A, the provision was 25 percent greater. By expanding Citizens' eligibility criteria and thereby increasing its policy growth, this proposal has the effect of placing Citizens in more direct competition with the voluntary market. However, the voluntary market may continue to "keep out" policies from Citizens, provided the premium is no more than 15 percent greater than Citizens' premium.

The provision may also raise the issue of Citizens federal tax exempt status.⁸ This provision places Citizens more into the role of a private insurer competing for insurance business in the voluntary market and less of a government controlled insurer of last resort that serves to augment the private insurance market.

The bill also extends the rate freeze for Citizens' rates for another year. Current law terminated the rate freeze on January 1, 2008 and the bill extends the termination date to January 1, 2009.

Certificate of Authority/"Pup" Companies

Insurance companies transacting insurance in Florida or from offices located in Florida are, with limited exceptions, required to have a certificate of authority (COA) issued by the Office of Insurance Regulation (OIR).⁹ To qualify for a COA, a prospective insurer¹⁰ must meet specified financial criteria including maintaining reserves¹¹ applicable to the kind of insurance transacted by the insurer, as well as maintaining specified assets, deposits, capital, and surplus. Insurers must provide the OIR with specified background information and meet trustworthiness, fitness, and criminal history requirements.

A COA may continue in force as long as the insurer meets the statutory requirements¹² of paying its annual license tax,¹³ filing its annual statement,¹⁴ and paying applicable taxes under the Insurance Code. The law does allow OIR to suspend or revoke an insurer's COA based on numerous criteria including being in unsound financial condition, committing practices which render its insurance transactions hazardous or injurious to its policyholders and violating lawful orders or rules of the OIR or FSC.

Current law does not forbid the formation of Florida domestic subsidiaries of national insurance companies ("pup companies"). According to the OIR, there may be as many as 27 Florida property and casualty domestic insurers that are wholly owned subsidiaries of insurers authorized to do business in another state. One such example is State Farm Florida Insurance Company¹⁵ which was formed as a wholly owned property insurance subsidiary (offering personal and commercial property insurance coverage) of State Farm Mutual Automobile Insurance Company which is domiciled in Illinois. State Farm Florida received its Florida COA in 1998 from the Department of Insurance.¹⁶ The insurer

⁸ On February 20, 2002, the Internal Revenue Service (IRS) in a private letter ruling to the Department of Insurance and after reviewing the provisions of the act creating Citizens determined that Citizens would be exempt from federal taxes. This allowed Citizens to collect revenues tax-free and issue tax-free bonds. (IRS Index Number: PLR-163640-01.)

⁹ Section 624.401, F.S.

¹⁰ Insurers are divided into three categories under the Insurance Code: *domestic insurers* are formed under the laws of Florida; *foreign insurers* are formed under the laws of any state, district, or territory or commonwealth of the United States, other than Florida; and *alien insurers* are defined as insurers other than domestic or foreign insurers. Foreign and alien insurers must also meet certain capital, surplus, and operational requirements.

¹¹ Part I of ch. 625, F.S.

¹² Section 624.416, F.S.

¹³ Section 624.501(3), F.S.

¹⁴ Section 624.424, F.S.

¹⁵ DOI Case Nos. 26914-98-CO and 26390-98-C.

¹⁶ In 2002, the programs, employees and trust funds of the Department of Insurance were transferred to the Department of Financial Services and the Financial Services Commission (Office of Insurance Regulation). (ch.2002-404, F.S.)

currently has over one million policies and has a 20.6 percent market share in Florida. State Farm Mutual has always sold property insurance via wholly owned subsidiaries for the past fifty years, according to a State Farm representative.

Although HB 1A did not address the formation of new “pup companies” in Florida, it increased the minimum surplus requirements for residential property insurance “pup companies” from \$5 million to \$50 million.¹⁷

Also, current law does not require and the OIR does not review the profits of national parent companies of wholly owned Florida subsidiaries when considering a rate filing.

Effect of Proposed Changes

The bill provides that effective January 1, 2008, and notwithstanding any other provision of law:

1. A new certificate of authority for the transaction of residential property insurance may not be issued to any insurer domiciled in Florida that is a wholly owned subsidiary of an insurer authorized to do business in any other state; and
2. The rate filings of any insurer domiciled in this state that is a wholly owned subsidiary of an insurer authorized to do business in any other state must include information relating to the profits of the partner company of the insurer domiciled in this state.

Provision # 2 could be interpreted to allow the OIR to consider the profitability of an insurer’s parent company during rate reviews. However, according to the OIR, such considerations are outside the bounds of the historical rate review process in virtually every state. The profit of the parent is not relevant to the losses and expenses that support the rate filing of an insurer doing business in Florida. Normally, an insurance regulator reviews premiums, claims costs, loss adjustment expenses and other related expenses it is review of an insurer.

C. SECTION DIRECTORY:

Section 1: Amends s. 627.351(6), relating to Citizens Property Insurance Corporation.

Section 2: Creates an unnumbered section, relating to “pup companies” and inclusion of parent company profits in rate filings for “pup companies.”

Section 3: Provides an effective date of “upon becoming a law” unless otherwise expressly provided in the bill.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

See FISCAL COMMENTS below.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

¹⁷ Section 624.407, F.S.

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

D. FISCAL COMMENTS:

Although the bill has no direct fiscal impact on the state, it does significantly increase the potential moral obligation of the state to cover Citizens' losses should there occur another hurricane season comparable to the 2004 and 2005 storms. By freezing the rates for an additional year until January 1, 2009, Citizens inability to set actuarially sound rates that will build reserves to cover losses will be exacerbated. In addition, the effect of HB 1A which increased the potential loss exposure of Citizens by expanding market share and adding more clients compounds this problem.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

The mandates provision does not apply because this bill does not: require counties or municipalities to spend funds or to take an action requiring the expenditure of funds; reduce the authority that municipalities or counties have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided in the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

D. STATEMENT OF THE SPONSOR

No statement submitted.

IV. AMENDMENTS/COUNCIL SUBSTITUTE CHANGES

On April 12, 2007, the Jobs and Entrepreneurship Council considered the bill, adopted a strike-all amendment, and reported the bill favorably with a Council Substitute. The strike-all amendment provided as follows:

- Revised legislative findings for Citizens to protect tax exempt status.
- Removed authority for Citizens to offer multi-peril coverage in High Risk Account because this provision is duplicative of what was contained in HB 1A passed during Special Session.
- Allowed a homeowner to obtain property insurance in Citizens even if the homeowner has an offer from the private market if the private market premium is 15% more than the Citizens' premium, rather than 25% more.

- Extended the rate freeze for Citizens rates from 2007 only to 2007 and 2008.
- Prohibited the formation of new pup companies starting January 1, 2008.
- Required the pup insurer's rate filing to include information about the profits of the parent insurer.
- Changed the title from "an act relating to Citizens Property Insurance Corporation" to "an act relating to property insurance" to avoid adequate title susceptibility.

The staff analysis was amended to reflect the adoption of the strike-all amendment.