

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/HB 701 Insurance Contracts  
**SPONSOR(S):** Jobs & Entrepreneurship Council, Ross and others  
**TIED BILLS:** **IDEN./SIM. BILLS:** SB 1748

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Committee on Insurance</u>	<u>9 Y, 0 N</u>	<u>Callaway</u>	<u>Overton</u>
2) <u>Jobs &amp; Entrepreneurship Council</u>	<u>13 Y, 0 N, As CS</u>	<u>Callaway</u>	<u>Thorn</u>
3) _____	_____	_____	_____
4) _____	_____	_____	_____
5) _____	_____	_____	_____

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### SUMMARY ANALYSIS

For those employers engaged in the construction industry that obtain workers' compensation insurance from a self-insurance fund, the bill prohibits contractors from rejecting the workers' compensation insurance based solely on the fact the insurance provider, the self-insurance fund, is not rated by a nationally recognized insurance rating service. This preclusion is only effective if the self-insurance fund participates in the Florida Workers' Compensation Insurance Guaranty Association. There is no current law requiring workers' compensation insurers or self-insurance funds to be rated by a rating service as a condition of being licensed to write workers' compensation insurance.

This bill also adds a provision to current law to give insurers the authority to require commercial insurance policyholders to purchase one or more lines of insurance or coverage in order for the commercial policyholder to purchase another line or coverage. There is no similar-type provision in current law and in fact, the Insurance Unfair Trade Practices Act precludes an insurer from refusing to insure a risk solely because the policyholder or applicant for insurance will not agree to place collateral business with the insurer.

The bill does not appear to have a fiscal impact on state or local government.

This bill is effective July 1, 2007,

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

**Safeguard Individual Liberty:** The bill prohibits a contractor from rejecting workers' compensation coverage from a self-insurance fund of another contractor solely because the coverage is not obtained from a nationally rated self-insurance fund as long as the fund participates in a guaranty association.

#### B. EFFECT OF PROPOSED CHANGES:

##### **Background on Construction Contracts and Insurance Requirements**

Most general contractors and subcontractors carry numerous kinds of insurance, such as workers' compensation<sup>1</sup> and commercial liability. Insurance costs are factored into the contractors' bids on a construction project. Insurance requirements for a particular construction project are included in the resulting construction contracts between the owner and general contractor, the general contractor and subcontractor, and/or subcontractor and sub-subcontractor or materialman.

Although there are no laws specifically addressing the practice, a general contractor or subcontractor may require, as a part of the construction contract, a certificate of insurance or an insurance policy to be submitted by a subcontractor as a condition of work. The certificate of insurance is evidence of insurance in lieu of an actual copy of an insurance policy. At some point upon signing a construction contract, sometimes before the work begins and sometimes after, the subcontractor provides a certificate of insurance to the general contractor listing the insurance provided by the subcontractor. Most times the general contractor reviews all documents required to be submitted under the construction contract, including the certificate of insurance, prior to paying the first invoice for each subcontractor. If an insurance policy or certificate of insurance is not submitted or if it does not meet the standards of the general contractor requiring the policy under the contract, the contractor may prohibit the other party from working on the construction project or may withhold payment for work already done until the proper insurance is obtained and proof is submitted.

According to proponents of the bill, as part of the construction contract, some contractors, typically general contractors, require their subcontractors to obtain workers' compensation insurance from an insurer that is rated by a nationally recognized insurance rating service (e.g., A.M. Best, Standard & Poor's, Moody's). The contractors further require the insurer to maintain a specified rating from the rating service (e.g. A, A- or better). If a subcontractor's workers' compensation insurance is not written by a rated insurer, in order to overcome any insurance concern, some general contractors allow subcontractors to furnish evidence the subcontractor has a reinsurance endorsement with a reinsurer meeting the rating requirement<sup>2</sup> or to furnish financial information about the subcontractor's insurer for the general contractor to review. However, some general contractors do not allow subcontractors to provide information to overcome the insurance concern.

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<sup>1</sup> Employers in the construction industry with one or more employee must provide workers' compensation coverage for its' employees. s. 440.02(17)(b)2., F.S. (2006). If a subcontractor does not have workers' compensation coverage, the general contractor must provide workers' compensation benefits for any injured employee of the subcontractor. This is true even if the subcontractor lied to the general contractor about his or her workers' compensation insurance coverage or gave the general contractor a fraudulent certificate of workers' compensation insurance coverage. John J. Dubreuil, *Florida Workers' Compensation Handbook*, 3-43 (2003 Edition, 2003).

<sup>2</sup> Typically, a "cut-through" endorsement to a reinsurer is required. This is a guarantee by a reinsurance company that payment for losses incurred by a third party (i.e. general contractor) will be made even though that third party has no contractual arrangement with the reinsurance company.

## **Background on Rating of Insurance Companies and Self-Insurance Funds**

Five independent agencies – A.M. Best, Fitch, Moody’s, Standard & Poor’s, and Weiss – rate the financial strength of insurance companies. Each agency has its own rating scale, its own rating standards, its own population of rated companies, and its own distribution of companies across its scale. Each rating agency uses numbers or pluses and minuses to indicate minor variations in rating from another rating class. Rating agencies can disagree about an insurance company’s rating and over time ratings can change for companies.

Rating agencies also rate self-insurance funds. Self-insurance funds are created for the purpose of pooling and spreading liabilities of its group members in any commercial property or casualty risk or surety insurance. Under s. 624.4621, F.S., two or more employers are allowed to pool their workers’ compensation liabilities and form a self insurance fund for workers’ compensation purposes. This type of self-insurance fund is called a group self-insurance fund.

A group self-insurance fund must comply with administrative rules adopted by the Financial Services Commission<sup>3</sup> relating to reserve requirements, organization, and operation. The rules relating to reserve requirements are designed to insure the self-insurance fund can maintain financial solvency. Current law also requires workers’ compensation self-insurance funds to carry reinsurance, unless the fund is comprised of state or local government employers.<sup>4</sup> Current law establishes restrictions on dividend or premium refunds made by a workers’ compensation self insurance fund.<sup>5</sup> Workers’ compensation self-insurance funds are subject to the insurance premium tax, but at a reduced rate. The rate is reduced from 1.75 percent of the gross receipt of insurance premiums to 1.6 percent.<sup>6</sup> Workers’ compensation self-insurance funds are subject to license taxes and premium receipt taxes.<sup>7</sup> Current law also requires workers’ compensation self-insurance funds to participate in the Florida Self-Insurance Fund Guaranty Association (Association).<sup>8</sup> The Association will step in and pay workers’ compensation claims of self-insurance funds that become insolvent.<sup>9</sup>

## **Effect of Proposed Changes Relating to Construction Contracts and Self-Insurance Funds**

There is no current law requiring workers’ compensation insurers or self-insurance funds to be rated by a rating service as a condition of being licensed to write workers’ compensation insurance. For those employers engaged in the construction industry that obtain workers’ compensation insurance from a self-insurance fund, the bill prohibits contractors from rejecting the workers’ compensation insurance based solely on the fact the insurance provider, the self-insurance fund, is not rated by a nationally recognized insurance rating service. This preclusion is only effective if the self-insurance fund participates in the Florida Workers’ Compensation Insurance Guaranty Association.

## **Bundling of Commercial Insurance Products**

Generally, section 626.9541(1)(x)3. provides that it is an unfair method of competition and an unfair or deceptive act or practice for an insurer to refuse to insure a risk solely because an insured or applicant for insurance will not agree to place collateral business with the insurer. Accordingly, there is no

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<sup>3</sup> The Financial Services Commission is comprised of the Governor and Cabinet.

<sup>4</sup> s. 624.4621(4), F.S. (2006).

<sup>5</sup> s. 624.4621(5), F.S. (2006).

<sup>6</sup> s. 624.4621(7), F.S. (2006) s. 624.509(1), F.S. (2006).

<sup>7</sup> s. 624.509(2), F.S. (2006).

<sup>8</sup> s. 624.4621(9), F.S. (2006) Pursuant to s. 631.911, F.S., the Florida Self-Insurance Fund Guaranty Association was merged into the Florida Workers’ Compensation Insurance Guaranty Association and the Florida Self-Insurance Fund Guaranty Association no longer exists. The merger occurred on October 1, 1997.

<sup>9</sup> s. 631.913, F.S. (2006).

current law allowing insurers to require policyholders to purchase one or more lines of insurance or coverages in order for the policyholder to purchase another line or coverage.

### **Effect of Proposed Changes Relating to Bundling of Commercial Insurance Products**

This bill adds a provision to current law to give insurers the authority to require commercial insurance policyholders to purchase one or more lines of insurance or coverage in order for the commercial policyholder to purchase another line or coverage. Proponents of the bill allege this may increase the capacity for commercial property insurance because an insurer is more likely to accept a marginal risk on one line of coverage if it can combine the marginal risk with a more profitable risk. Additionally, proponents believe this is a viable option for commercial policyholders because commercial entities are generally more sophisticated purchasers and have risk managers handling their insurance and because there is substantial competition among insurers for their business. They further assert this provision in the bill will not require any commercial entity to purchase the coverages together unless it makes economic sense to do so and may produce discounts by allowing the combined coverages in one policy.<sup>10</sup>

According to the Office of Insurance Regulation, this provision in the bill may not be a problem for large commercial risks because these risks typically have a sophisticated buyer and seller which have co-equal bargaining power and skills.<sup>11</sup> However, the Office believes the bill's provision allowing bundling of commercial risks may be problematic for other entities, such as condominium associations, daycare centers, or other types of less sophisticated or smaller entities. Additionally, the Office believes the bill's provision could be problematic for those commercial entities looking for insurance coverage in a limited market, such as condominium associations trying to obtain residential property insurance. In such a case, all insurance carriers could require the condominium association to bundle commercial coverages in order for the association to purchase property insurance, thus limiting the association's insurance choices.

#### **C. SECTION DIRECTORY:**

**Section 1:** Creates s. 627.4415 relating to commercial insurance contracts.

**Section 2:** Creates s. 627.442, F.S. relating to insurance contracts.

**Section 3:** Provides an effective date of July 1, 2007.

## **II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

#### **A. FISCAL IMPACT ON STATE GOVERNMENT:**

1. Revenues:

None.

2. Expenditures:

None.

#### **B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

1. Revenues:

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<sup>10</sup> Information on file with Committee on Insurance.

<sup>11</sup> Information on file with Committee on Insurance dated April 2, 2007.

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may result in some expansion of the use of self-insurance funds by construction subcontractors.

D. FISCAL COMMENTS:

None.

### 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 March 29, 2007, the Jobs and Entrepreneurship Council considered the bill, adopted one amendment, and reported the bill favorably with a council substitute. The amendment added a provision to the bill to allow commercial insurers to require commercial insurance applicants to purchase two or more types of commercial coverage together in one or more commercial insurance contracts. However, the amendment did not prohibit a commercial insurer from offering each type of commercial coverage separately or combine two or more coverages into one commercial policy. The staff analysis was updated to reflect the adoption of the amendment.