HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1007 Insurer Insolvency
SPONSOR(S): Insurance & Banking Subcommittee, Bernard, Julien, Cruz and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 1568

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	10 Y, 0 N, As CS	Cooper	Cooper
2) Government Operations Appropriations Subcommittee			
3) Economic Affairs Committee			

SUMMARY ANALYSIS

Chapter 631, F.S., relates to insurer insolvency and guaranty payments and governs the receivership process for insurance companies in Florida. Federal law specifies that insurance companies cannot file for bankruptcy. Instead, they are either "rehabilitated" or "liquidated" by the state. In Florida, the Division of Rehabilitation and Liquidation of the Department of Financial Services (DFS) is responsible for rehabilitating or liquidating insurance companies. This process involves the initiation of a delinquency proceeding and the placement of an insurer under the control of DFS as the receiver.

When an insurer is in liquidation, DFS must pay claims based upon a priority established by state law. However under Federal law, claims of the United States government in an insurance company receivership estate have priority above all other claims except policyholder level claims and administrative expenses. Additionally, there is no limit on when the government can file those claims. If DFS pays claims to others, such as employees of the insurer, creditors, or claims of any state or local government and the Federal government subsequently files a claim and funds are unavailable, the officers and employees of DFS can be held personally liable for the amount due. This situation has severely hampered the administration of insurers' estates and the payment of valid claims.

The bill provides coverage by the State Risk Management Trust Fund to specified officers and employees of DFS for any liability under the Federal act relating to priority of claims for any action taken by then in the performance of their receivership duties.

The bill makes other changes relating to the responsibilities of the Division of Rehabilitation and Liquidation. It authorizes DFS to be appointed an ancillary receiver to an out-of-state insurer when it is necessary to obtain records to adjudicate the covered claims of Florida policyholders. It also subjects individuals, who are already compelled to cooperate in providing records to DFS or face criminal penalties, to liability for penalties, fines, or other costs assessed against a guaranty association or the receiver that result from the individuals' refusal or delay in providing records.

The bill amends provisions relating to the Florida Insurance Guaranty Association and the Florida Workers' Compensation Insurance Guaranty Association by redefining "covered claims" to exclude certain claims rejected by another state's guaranty fund. With respect to the board of directors of both these associations, the bill allows for the quick termination of a member who represents, or has a material relationship with, an insurer in receivership.

Regarding coverage provided by the State Risk Management Trust Fund, the bill should have a minimal fiscal impact. Large claims owed to the federal government are often quickly pursued by the affected agencies and DFS has experienced recent success in obtaining limited releases from the United States Justice Department. On the other hand, providing DFS the security to pay valid claims to deserving parties will result in a positive fiscal outcome to those affected.

The bill takes effect July 1, 2011.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background:

Insurer Insolvency: Rehabilitation and Liquidation

Chapter 631, F.S., relates to insurer insolvency and guaranty payments and governs the receivership process for insurance companies in Florida. Federal law specifies that insurance companies cannot file for bankruptcy.[1] Instead, they are either "rehabilitated" or "liquidated" by the state. In Florida, the Division of Rehabilitation and Liquidation of the Department of Financial Services (DFS) is responsible for rehabilitating or liquidating insurance companies.[2] This process involves the initiation of a delinquency proceeding and the placement of an insurer under the control of the department as the receiver.

For insurance companies in liquidation, current law establishes the priority of distribution of claims from an insurer's estate.[3] Claims are categorized into classes and every claim in each class must be paid in full or adequate funds must be retained for such payment before the members of the next class can receive any payment. The priority schedule is comprised of ten classes of claims. In essence, claims are paid in the following order for: 1) administrative expenses; 2) policyholder losses; 3) unearned premiums; 4) claims of the Federal government; 5) debts due to employees; 6) claims of creditors; 7) claims of state or local governments; 8) late filed claims; 9) surplus or similar obligations and premium refunds on assessable policies; and 10) claims of shareholders or other owners.

A significant problem has arisen over the years which has restricted the distribution of assets and closing of estates in receiverships. This has occurred because in these types of cases, the Federal Priority Statute[4] gives the United States government priority for payment above all other claims except policyholder level claims and administrative expenses.[5] Furthermore, Federal courts have decreed that the United States government is not subject to any claims filing deadline or statute of limitations.[6] The Federal Government can therefore file a claim in one of the estates at any time. If DFS as receiver does not have the funds to pay the claim because distribution has already been made on lower priority claims, the DFS officials performing the duties of the receiver can be held personally liable for the amount of the unpaid federal claim. Based upon this potential liability to individual DFS managers, DFS has been extremely cautious in paying claims below class 4 in any of their estates.

Insurance Guaranty Funds

Florida operates five insurance guaranty funds to ensure policyholders of liquidated insurers are protected with respect to insurance premiums paid and settlement of outstanding claims, up to limits provided by law.[7] A guaranty association generally is a not-for-profit corporation created by law

---

[1] The Bankruptcy Code expressly provides that "a domestic insurance company" may not be the subject of a federal bankruptcy proceeding. 11 U.S.C. § 109(b)(2). The exclusion of insurers from the federal bankruptcy court process is consistent with federal policy generally allowing states to regulate the business of insurance. See 15 U.S.C. § 1012 (McCarran-Ferguson Act).

[2] Typically, insurers are put into liquidation when the company is insolvent whereas insurers are put into rehabilitation for numerous reasons, one of which is an unsound financial condition. The goal of rehabilitation is to return the insurer to a sound financial condition. The goal of liquidation, however, is to dissolve the insurer. *See* s. 631.051, F.S., for the grounds for rehabilitation and s. 631.061, F.S., for the grounds for liquidation.

[3] s. 631.271, F.S.

[4] 31 U.S.C. § 3713

[5] United States Department of Treasury v. Fabe, 508 U.S. 491 (1993)

[6] Ruthardt v. United States, 303 F.3d 375 (1st Cir. 2002).

[7] The Florida Life and Health Insurance Guaranty Association generally is responsible for claims settlement and premium refunds for health and life insurers who are insolvent. The Florida Health Maintenance Organization Consumer Assistance Plan offers assistance to members of an insolvent Health Maintenance Organization (HMO) and the Florida Workers' Compensation Insurance Guaranty Association is directed by law to protect policyholders of insolvent workers' compensation insurers. The Florida Self-Insurers Guaranty Association protects policyholders of insolvent individual self-insured employers for workers' compensation claims. The Florida Insurance Guaranty Association is responsible for paying claims for insolvent insurers for most remaining lines of insurance, including residential and commercial property, automobile insurance, and liability insurance, among others.

directed to protect policyholders from financial losses and delays in claim payment and settlement due to the insolvency of an insurance company. A guaranty association accomplishes its mission by assuming responsibility for settling claims and refunding unearned premiums[8] to policyholders. Insurers are required by law to participate in guaranty associations as a condition of transacting business in Florida.

Two of the five guaranty funds are affected by the bill. They are the Florida Insurance Guaranty Association which is the guaranty association for property and casualty insurance, and the Florida Workers' Compensation Insurance Guaranty Association which is the guaranty association for workers' compensation insurance.

Florida Insurance Guaranty Association (FIGA)

Statutory provisions relating to FIGA, which was created in 1970, are contained in part II of chapter 631, F.S. FIGA operates under a board of directors and is a nonprofit corporation. FIGA is composed of all insurers licensed to sell property and casualty insurance in the state.
By law, FIGA is divided into two accounts:

- the auto liability account and auto physical damage account; and
- the account for all other included insurance lines (the all-other account).[9]

When a property and casualty insurance company becomes insolvent, FIGA is required by law to take over the claims of the insurer and pay the claims of the company's policyholders. This ensures policyholders that have paid premiums for insurance are not left without valid claims being paid. FIGA is responsible for claims on residential and commercial property insurance, automobile insurance, and liability insurance, among others.
The maximum claim amount FIGA will pay is $300,000 but special limits apply to damages to structure and contents on homeowners', condominium, and homeowners' association claims. For damages to structure and contents on homeowners' claims FIGA pays an additional $200,000, for a total of $500,000. For condominium and homeowners' association claims FIGA pays the lesser of policy limits or $100,000 multiplied by the number of units in the association. All claims are subject to a $100 FIGA deductible, in addition to any deductible in the insurance policy.

FIGA obtains funds to pay claims of insolvent insurance companies primarily from the liquidation of assets of these companies done by the Division of Rehabilitation and Liquidation in the Department of Financial Services. FIGA also obtains funds from the liquidation of assets of insolvent insurers domiciled in other states but having claims in Florida.

In addition, after insolvency occurs, FIGA can issue two types of assessments against property and casualty insurance companies to raise funds to pay claims – regular and emergency[10] assessments. FIGA assesses member insurance companies directly for both assessments and the insurance company is allowed by law (s. 631.57(3)(a), F.S.) to pass the assessment on to their policyholders.

FIGA only pays "covered claims" as defined by s. 631.54(3), F.S. Current law provides two exclusions to the definition of "covered claims." One prevents FIGA from paying subrogation, contribution, or indemnification claims of the insolvent insurer. The other exclusion prevents FIGA from paying claims that have been rejected by another state's guaranty fund for payment because the policyholder's net worth is more than what is allowed under the other state's guaranty law. FIGA cannot pay these claims even if the claim otherwise meets the definition of "covered claim" in Florida law.

Florida Workers' Compensation Insurance Guaranty Association (FWCIGA)

The Florida Workers' Compensation Insurance Guaranty Association (FWCIGA) was created in 1997 by merging the workers' compensation account in FIGA with the Florida Self-Insurance Fund Guaranty Association.[11] The FWCIGA pays workers' compensation and employer liability claims of insolvent

---

[8] The term "unearned premium" refers to that portion of a premium that is paid in advance, typically for six months or one year, and which is still owed on the unexpired potion of the policy.
[9] s. 631.55(2), F.S.
[10] Emergency assessments can only be issued to pay claims of insurers rendered insolvent due to a hurricane.
[11] Ch. 97-262, L.O.F.

insurers and group self-insurance funds licensed in Florida, as well as unearned premium claims.[12] FWCIGA does not have a coverage limit for workers' compensation claims of insolvent insurers, but has a $300,000 coverage limit for employer liability claims.

FWCIGA is largely funded by industry assessments against workers' compensation insurers and self-insurance funds insuring workers' compensation, which are collected following insolvencies. These assessments raise funds to pay claims and administrative and other costs related to the FWCIGA's claim paying activities.

FWCIGA's assessments are capped at 2 percent for insurance companies and 1.5 percent for self-insurance funds net direct premium written in Florida the prior year. The other source of funding is recoveries from receivers of the insolvent insurance companies.

Effect of the Bill:

Receivership Proceedings

Currently, DFS may be appointed, under certain conditions, to be an ancillary receiver to liquidate the business and assets of a foreign insurer which has assets, business, or claims in this state. This can occur upon the appointment of a receiver in the domiciliary state of such of an insurer when the purpose is to liquidate the insurer.[13] The appointment of DFS to be an ancillary receiver is also predicated upon DFS finding that there are sufficient assets of the insurer located in this state to justify the appointment of an ancillary receiver, or if ten more Florida residents having claims against the insurer file a petition with the DFS or the Office of Insurance Regulation (OIR) requesting the appointment of an ancillary receiver.[14]

The bill adds a third basis for DFS seeking to be appointed an ancillary receiver. It allows DFS to petition for appointment if necessary to obtain records to adjudicate the covered claims of Florida policyholders.

Another aspect of current law is modified relating to the delinquency proceedings of foreign insurers. Currently, in the event that initiation of delinquency proceedings (whether involving a domestic or foreign insurer) does not result in appointment of the DFS as receiver, or in the event that the funds or assets of an insurer for which DFS is appointed as receiver are insufficient to cover the cost of certain administrative expenses there is appropriated, upon approval of the Chief Financial Officer and of the Legislative Budget Commission from the Insurance Regulatory Trust Fund to the Division of Rehabilitation and Liquidation, a sum that is sufficient to cover the unreimbursed costs.[15] The bill makes these same provisions apply to the unreimbursed costs for ancillary proceedings opened for the purpose of obtaining records necessary to adjudicate the covered claims of Florida policyholders.

Currently, individuals with control over the affairs of an insurer must fully cooperate with DFS or OIR in any rehabilitation or liquidation proceeding. An integral part of this requirement is to promptly respond to inquiries, make available and deliver specified documents and provide access to all data processing records and facilities. Failing to cooperate subjects the party to a first degree misdemeanor charge and possible fine.[16]
The bill adds another consequence for refusing to cooperate in providing requested records. Any person so refusing is made liable for any penalties, fines or other costs assessed against a guaranty association or the receiver that result from the refusal or delay to provide records.

Guaranty Funds Provisions

[12] FWCIGA does not pay claims for insolvent self-insured employers, which are covered by a separate guaranty association (s. 440.385, F.S.)
[13] s. 631.091, F.S.
[14] s. 631.152, F.S.
[15] s. 631.141 (7)(b), F.S.
[16] s. 631.391, F.S.

The bill expands the current exclusions to what is considered a covered claim for the purposes of what cannot be paid by FIGA or FWCIGA. It deletes the specific exclusion from coverage of a claim rejected by another state's guaranty based on the grounds that an insured's net worth is greater than that allowed under that states guaranty law.[17] The bill replaces it with a broader exclusion. It excludes any claim that would otherwise be a covered claim that has been rejected or denied by any other state guaranty fund based upon that state's statutory exclusions including, but not limited to, those based on coverage, policy type, or an insured's net worth. This change will reduce the likelihood of Florida having to make its coverage dependent upon the decisions of the legislatures of other states. For example, currently other states have enacted legislation excluding large deductible policies from coverage by their guaranty funds and Florida might have to pay those claims if a nexus with Florida could be established. The bill seeks to diminish this effect.

Also regarding FIGA and FWCIGA, the bill adds provisions which will allow for the immediate termination of board members. For FIGA, it states that any board member representing an insurer in receivership shall be terminated from the board effective as of the date of the entry of the order of receivership. For FWCIGA, the bill provides that any board member that is employed, by or has a material relationship with, an insurer shall be terminated as a board member, effective as of the date of the entry of the order of receivership. Currently for FWCIGA, the law allows the Chief Financial Officer to remove any board member for cause whereas the FIGA provisions for removal from the board are silent. The effect of these changes will mean that immediate action can occur to eliminate any potential conflict of interest on the board.

Payment of Claims by DFS

The bill creates a new section of law to require the State Risk Management Trust Fund to cover DFS officers, employees, agents, and other representatives for any liability under the Federal Priority of Claims Act from any action taken by those individuals in the performance of their powers and duties under chapter 631, F.S.
Extending coverage to protect DFS employees from this personal liability would allow those employees to timely administer and distribute an estate without fear that a federal claim will arise later and they will be subjected to personal liability for having paid that claim. Although the receiver has had some modest success obtaining releases from the U.S. Department of Justice, a federal claim can arise from any of the many federal agencies, and the federal government has no one source that can adequately verify that there is not any federal agency that has a claim.

This provision would, in effect, only become operable where an insolvent insurer's estate: 1) had funds available to pay beyond class 4 claims; 2) those claims beyond class 4 were paid by an estate distribution, in full or in part; and 3) subsequently a claim was filed by the federal government which, because of its "super priority status" as a federal claim, was not barred by the state court ordered deadline to file claims.

B. SECTION DIRECTORY:

Section 1. Amends s. 631.152, F.S., relating to conduct of delinquency proceeding; foreign insurers.

Section 2. Creates s. 631.2715, F.S., relating to liability under federal priority of claims law.

Section 3. Amends s. 631.391, F.S., relating to cooperation of officers and employees.

Section 4. Amends s. 631.54, F.S., relating to definitions.

Section 5. Amends s. 631.56, F.S., relating to board of directors.

Section 6. Amends s. 631.904, F.S., relating to definitions.

[17] s. 631.54, F.S.

Section 7. Amends s. 631.912, F.S., relating to definitions.

Section 8. Provides an effective date of July 1, 2011.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   Indeterminate. See FISCAL COMMENTS

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill will allow DFS to distribute the marshaled assets of liquidated companies to claimants on a timelier basis and close estates.

D. FISCAL COMMENTS:

According to DFS the amount of any Federal claim that the change provided by this bill might impact should be minimal. In information provided by DFS the following statement was made:

> There is no certainty as to the number or amounts of claims that would be paid in the future if this legislation passes, simply because there is very little claims history available to use for predicting future results. But there are two indicators that provide some assurance that the frequency and severity of claims will be minimal:
>
> 1) In the forty or so years of DFS administering receiverships there has only been one instance where a federal claim was filed very late. In that instance a full distribution had been made of estate assets, but luckily additional unexpected funds came in later to the estate that allowed the federal claim to be paid. The claim was for about $40,000. In all other instances federal claims were filed in plenty of time before a final distribution, which normally takes 7 to 10 years to be made from the date an estate was opened. Therefore the frequency of these claims should be extremely low.
>
> 2) Just like any other person or public or private entity, the federal government pursues large claims more vigorously than smaller claims, and if they have a claim of for example $500,000 they are likely to make the stronger effort to determine where to file the claim, particularly if it involves a claim against an insurance company. Because of the length of time it takes to administer an estate, the federal government will have at least 7 to 10 years to find where they should file their claim. Therefore, it is likely that all large claims will be filed sooner and that the only claims that may come in very late are small claims. As

mentioned above, the only late claim received after a distribution was for only about $40,000. Therefore, the average severity as to the amount of any claims should be less than $50,000.[18]

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities 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:

The bill does not require nor modify any rule-making by the Department of Financial Services.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

None.

[18] Electronic correspondence sent March15, 2011, on file with the Insurance & Banking Subcommittee.