

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/CS/CS/HB 343 Wrap-Up Insurance Policies

SPONSOR(S): Regulatory Affairs Committee; Government Operations Appropriations Subcommittee; Insurance & Banking Subcommittee; Hager

TIED BILLS: **IDEN./SIM. BILLS:** CS/CS/SB 810

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	12 Y, 1 N, As CS	Reilly	Cooper
2) Government Operations Appropriations Subcommittee	13 Y, 0 N, As CS	Keith	Topp
3) Regulatory Affairs Committee	14 Y, 0 N, As CS	Reilly	Hamon

SUMMARY ANALYSIS

CS/CS/CS/HB 343 creates s. 627.4138, F.S., relating to wrap-up insurance policies for nonpublic construction projects. Under wrap-up insurance, utilized in large construction projects, one party (the project owner or the general contractor) purchases insurance coverage that applies to all parties performing work on the project. Wrap-up insurance typically includes workers' compensation, general liability, and other coverages. Advantages of wrap-up policies include significant savings in premium costs and elimination of gaps in coverage.

For employers with a minimum workers' compensation standard premium of \$500,000, an insurance policy may include a large deductible program (a deductible of \$100,000 or more per claim). Under such programs, the carrier is obligated to pay the claim from the first dollar. The insured (the employer) then reimburses the carrier, per claim, for losses paid within the large deductible. The Office of Insurance Regulation (OIR) reports that the typical large deductible policy will have a deductible credit that can range from 30 to 90%, significantly lowering premiums paid.

The bill authorizes wrap-up policies for nonpublic construction projects with an estimated total cost of \$25 million or more at each specified contracted work site to include large deductibles for workers' compensation claims when the combined workers' compensation standard premium for all covered entities exceeds \$500,000. It also requires the insurer to have an established program for having the first-named insured (the owner of the project, the general contractor, or a combination of the project owner and the general contractor) reimburse the insurer for losses paid within the deductible. The bill incorporates into Florida law many of the requirements of Administrative Rule 69O-189.006, F.A.C., for large deductible workers' compensation filings, including the following:

- The insurer is obligated to pay first dollar of all claims and reimbursement of the deductible by the insured does not affect the insurer's obligation to pay claims.
- The insurer complies with all filing requirements of the Department of Financial Services (DFS), and files all required data with the National Council on Compensation Insurance.

The bill will have a positive fiscal impact on project owners and general contractors that purchase wrap-up insurance with large deductible programs.

The DFS indicates that the bill has an insignificant fiscal impact on revenues deposited into the Workers' Compensation Special Disability Trust Fund (SDTF). Provisions of the bill will likely affect premiums of the SDTF because rates are based upon the premium after the application of deductible credits.

The bill is effective July 1, 2013.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Background on Workers' Compensation

Wrap-Up Insurance Policies

For large construction projects, project owners, contractors, and subcontractors have traditionally purchased insurance independently to protect themselves against financial losses related to the project. The contractors' costs of insurance would be included in their bids and thus would be paid by the project owner as part of the contract. Under this traditional insurance arrangement, the contractors could receive rebates from their insurers based on the contractor's safety record. In addition, some project owners would provide contractors with good safety records with additional bonuses. As the contractors' costs of insurance were paid by the project owner as part of the contract, subsequent rebates received by the contractors from their insurers have generated additional profits for the contractor.

In contrast to the traditional arrangement, consolidated insurance programs, often referred to as "wrap-up" insurance, are offered in the insurance market for large construction projects. Wrap-up insurance is a program or series of insurance policies purchased by one party (e.g., the project owner or general contractor) to cover itself and all of its subordinate contractors and subcontractors for operations at a specific project site. Unlike traditional insurance in which each party purchases its own coverage, under wrap-up insurance, one party is responsible for purchasing insurance coverage that applies to all parties performing work on the project under contract. Among other coverages, wrap-up policies typically include workers' compensation and general liability coverage.

Wrap-up policies are commonly characterized by one of two types of consolidated insurance programs. In an owner-controlled program (OCIP),¹ the project owner purchases insurance to cover itself and all of its contractors and subcontractors. In a contractor-controlled insurance program (CCIP), the general contractor purchases coverage for itself and each of its subcontractors. In contrast to traditional insurance, the project owner pays the insurance premiums under an OCIP and receives the rebates from the insurer based on the project's safety record.

In 1999, the U.S. General Accounting Office (GAO) published a report analyzing the advantages and disadvantages of wrap-up insurance for large construction projects.² Based on an analysis of six large transportation projects, the report identified the following advantages and disadvantages of wrap-up policies.

Advantages

- Significant cost savings on the cost of traditional insurance, attributable to an owner's bulk-purchasing power and economies of scale. The GAO noted that large, labor-intensive projects would be in a better position to obtain wrap-up insurance.
- Eliminates duplication and overlap in coverage which may occur because the contractors and subcontractors are insuring themselves against the same accidents, even though they may not be liable for the resulting claims. With wrap-up insurance, gaps in coverage and the resulting uninsured claims can be avoided.

¹ Section 255.0517, F.S., specifies conditions under which state agencies, political subdivisions, state universities, community colleges, airport authorities or other public agencies may purchase OCIPs in connection with public construction projects. OCIPs may only be purchased for public construction projects with an estimated total cost of (a) at least \$75 million; (b) at least \$30 million if the project is for the construction or renovation of two or more public schools during a fiscal year, or (c) at least \$10 million if the project is for construction or renovation of one public school.

² U.S. General Accounting Office, "Transportation Infrastructure: Advantages and Disadvantages of Wrap-Up Insurance for Large Construction Projects," Report No. GAO/RCED-99-155 (June 1999). Available at <http://www.gao.gov> (last accessed: April 3, 2013).

- Provides for more efficient claims handling processes and less litigation since a single insurer is used for reporting claims, conducting investigations, settling claims, and providing for payment of claims.
- Facilitates comprehensive safety programs. The GAO notes that a significant portion of the potential savings from wrap-up insurance derives from a well-managed centralized safety program that results in fewer injuries.

Disadvantages

- Increased administrative costs. Additional resources related to emphasizing job safety, controlling losses, and managing claims were noted. Some project owners outsource these administrative functions to insurance brokers or agents, while others perform some or all of the functions with their staffs.
- Potentially requires owners to make large premium payments at the start of a construction project and to establish a special reserve in order to ensure that funds are available to pay deductible requirements on claims.

Workers' Compensation Insurance Policies with Large Deductibles

In the early 1990s, insurers approached the Department of Insurance [the predecessor to the Office of Insurance Regulation (OIR)] about filing a workers' compensation rating plan for large employers (defined as having \$500,000 in standard premium) that would be more flexible in how premium would be determined. The justification for the flexibility was based on the following general concepts:

- The rating plan would be used only for very large employers. These employers would generally be eligible to be individually self-insured.
- Rating is similar to rating for excess insurance that is purchased by individual self-insureds.
- The minimum deductible is \$100,000 and could be in the millions. Thus, the employer would be responsible for the vast majority of claims.

These type plans with restrictions were ultimately approved and incorporated in Administrative Rule 690-186.006, F.A.C. (formerly 4-189.006).³ The administrative rule establishes guidelines for large deductible (a deductible of \$100,000 or more per claim) workers' compensation filings. In order to qualify for a large deductible policy, an employer must have a workers' compensation standard premium of at least \$500,000.⁴

Under large deductible programs, the carrier is obligated to pay the claim from the first dollar, as though there were no deductible. The insured (the employer) then reimburses the workers' compensation carrier, for each claim, for losses paid within the deductible. The OIR reports that the typical large deductible policy will have a deductible credit that can range from 30 to 90%. Thus, the premiums paid by employers and reported by insurers will be a fraction of premiums paid for other rating plans. An ancillary effect of large deductibles has been the movement for very large employers to cease being individually self-insured and to buy an insurance policy from an insurance company with a large deductible program.

The OIR notes that in recent insolvencies there have been problems with large deductible policies and the lack of collectible collateral. This will result in the Florida Workers' Compensation Insurance

³ See "2012 Workers' Compensation Annual Report" (December 2012) by the Florida Office of Insurance Regulation. Available at <http://www.floir.com> (last accessed: April 3, 2013).

⁴ Before the availability of large deductible programs, retrospective rating plans were the dominant rating plan for large employers. Under a retrospective rating plan, the final premium paid by the employer is based on the actual loss experience of the employer during the policy, plus insurer expenses and an insurance charge. If the employer controls the amount of claims, it pays lower premiums.

Guaranty Association (FWCIGA)⁵ paying over \$50 million that will ultimately be assessed to all workers' compensation policyholders in Florida.⁶

Limited Availability of Wrap-Up Policies with Large Deductibles

Though remote, the possibility currently exists that a Florida wrap-up policy for a nonpublic construction project could provide for a large deductible for workers' compensation claims. Among the criteria to be met would be that each entity covered under the wrap-up policy have a minimum workers' compensation standard premium of \$500,000.⁷ Satisfaction of this requirement would likely be rare, as every entity on a construction project would need to be an extremely large employer and small subcontractors would be excluded. Staff is not aware of any wrap-up policy with a large deductible for workers' compensation claims that has been issued for a nonpublic construction project in Florida.

Effect of the bill

The bill creates s. 627.4138, F.S., relating to wrap-up insurance policies for nonpublic construction projects. The bill authorizes wrap-up policies for nonpublic construction projects with an estimated total cost of at least \$25 million at each specified contracted work site to include large deductibles for workers' compensation claims (a deductible of \$100,000 or more per claim) when the combined workers' compensation standard premium for all covered entities exceeds \$500,000. The bill also requires the insurer to have an established program for having the first-named insured (the owner of the project, the general contractor, or a combination of the project owner and the general contractor) reimburse the insurer for losses paid within the deductible. The bill incorporates into Florida statutes many of the requirements of Administrative Rule 69O-189.006, F.A.C., for large deductible workers' compensation filings, namely that:

- The insurer is obligated to pay first dollar of a claim as any other workers' compensation policy without a deductible.
- Reimbursement of the deductible by the insured does not affect the insurer's obligation to pay claims.
- The insurer complies with all filing requirements of the Department of Financial Services under the workers' compensation law for all losses, including those below the deductible limit.
- The insurer files unit statistical reports with the National Council on Compensation Insurance (NCCI) that show all losses, including those below the deductible limit.
- The insurer files with the NCCI the unit statistical reports necessary for calculation of an experience modification factor.
- The insurer complies with NCCI aggregate financial calls, detail claim information calls, unit statistical reporting, and other required calls.

The bill also defines the following terms: specified contracted work site (construction being performed during one or more policy years at one site or multiple sites of the same construction project) and wrap-up insurance policy (policies issued to the nonpublic owner or the general contractor of a construction project through a consolidated insurance program which may provide general liability, property damage liability, workers' compensation, employers' liability, or pollution liability insurance coverage, or a combination of such coverages for the contractors and subcontractors working at a specified contracted work site of the construction project).

B. SECTION DIRECTORY:

⁵ FWCIGA's purpose is to provide a mechanism for the payment of covered claims, to avoid excessive delay in payment, and to avoid financial loss to claimants in the event of the insolvency of a member insurer. See <http://www.fwciga.org> (last accessed: April 3, 2013).

⁶ For additional discussion on employer and insurer solvency concerns and large deductible policies see "Workers' Compensation Large Deductible Study," NAIC/IAIABC Joint Working Group Study (March 2006). Available at http://www.naic.org/store_pub_whitepapers.htm (last accessed: April 3, 2013).

⁷ See, e.g., Rule 69O-186.006, F.A.C.

Section 1. Creates s. 627.4138, F.S., relating to wrap-up insurance policies for nonpublic construction projects.

Section 2. Provides an effective date of July 1, 2013.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

See Fiscal Comments.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The OIR reports that the bill will increase costs to subcontractors that will be required to participate in a large deductible wrap-up policy. To the extent that the bill increases the use of large deductible policies, the amount of premiums paid to insurers will decrease. Thus, the premiums reported by insurers to the state for assessment purposes will also decrease.

It is unclear whether the savings in premiums resulting from the use of large deductibles will be realized by subcontractors covered under a wrap-up policy or be retained by the owner or general contractor that has purchased the wrap-up policy.

D. FISCAL COMMENTS:

The Department of Financial Services (DFS) indicates that the bill has an insignificant fiscal impact on revenues deposited into the Workers' Compensation Special Disability Trust Fund (SDTF). Currently, the SDTF assessment rate is 1.43% of net premiums. Provisions of the bill would allow for the assessment of rates to the SDTF after a large deductible is applied, thus reducing the amount of the assessment base and impacting revenue collections. Should revenues decline, the Chief Financial Officer has the authority to increase the assessment rate in order to offset any loss in revenue⁸. DFS indicates that impacts of the bill will be insignificant and would only affect the SDTF premium base, and that the SDTF is more sensitive to expenditures rather than minor fluctuations of the premium base.⁹

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

⁸ Section 440.49(9), F.S.

⁹ E-mail correspondence from DFS dated March 4, 2013 on file with staff of the Insurance & Banking Subcommittee.

Not applicable. The 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:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 19, 2013, the Insurance & Banking Subcommittee considered and adopted a strike-all amendment to the bill. The amendment conformed the bill to the Senate companion (SB 810), retained all provisions of the House bill, and made the following changes:

- Clarified that wrap-up insurance means insurance “policies” issued “through a consolidated insurance program,” and is not a single policy that provides coverages across various lines of insurance.
- Limited eligibility for large deductible programs on wrap-up insurance policies on nonpublic construction projects to construction projects with a total estimated cost of at least \$25 million.
- Required the first-named insured (the owner of the project or the general contractor) to reimburse the insurer for losses paid within the large deductible.

On April 2, 2013, the Government Operations Appropriations Subcommittee adopted one amendment and reported the bill favorably as a committee substitute. The amendment:

- Clarifies that the estimated cost of construction to be performed is for each specified contracted work site of a construction project that is \$25 million or more.

On April 9, 2013, the Regulatory Affairs Committee adopted one amendment to the bill. The amendment clarified that the first-named insured responsible for reimbursing the insurer for losses paid within the deductible may be the owner of the project, the general contractor, or a combination of the project owner and the general contractor.

The staff analysis was updated to reflect the committee substitute as passed by the Regulatory Affairs Committee.