

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Commerce and Tourism

BILL: CS/SB 794

INTRODUCER: Banking and Insurance Committee and Senator Brandes

SUBJECT: Motor Vehicle Service Agreement Companies

DATE: March 27, 2017

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Matiyow</u>	<u>Knudson</u>	<u>BI</u>	<u>Fav/CS</u>
2.	<u>Harmsen</u>	<u>McKay</u>	<u>CM</u>	<u>Favorable</u>
3.	_____	_____	<u>RC</u>	_____

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 794 expands the methods by which a motor vehicle service agreement company may insure its ability to pay out on its warranty claims, specifically by allowing the motor vehicle service agreement company to procure insurance to cover its motor vehicle service agreement claim exposure from a risk retention group that is authorized to do business in Florida. The risk retention group must meet certain requirements that ensure its financial health.

The bill also allows a motor vehicle service agreement company that provides vehicle protection expenses to obtain insurance coverage on its warranty claims from an insurer that is affiliated with the company.

Lastly, the bill allows a lender, finance company, or creditor to cancel a motor vehicle service agreement if those entities are authorized to do so in the underlying service agreement.

II. Present Situation:

Warranty Associations

Warranty associations, which include motor vehicle service agreement companies,¹ home

¹ Section 634.011, F.S.

warranty associations,² and service warranty associations,³ are governed under ch. 634 of the Florida Insurance Code. Service warranties, also known as “extended warranties,” are contracts between a company and consumer that are designed to protect the consumer from certain losses due to failure or improper functioning of a mechanical or other component of the warranted object, e.g., car, air conditioner, or large appliance.⁴ Service warranties are not considered traditional insurance products.⁵ Therefore, warranty associations are not required to submit their rates for approval by the Office of Insurance Regulation (OIR) like traditional insurance companies.⁶

Service warranty associations are generally regulated by the OIR, but are exempt from all other provisions of the Florida Insurance Code unless otherwise specified.⁷ The OIR’s regulatory authority includes, among other duties, the licensure of warranty associations,⁸ disapproval of noncompliant service agreement forms,⁹ annual review of a warranty association’s statistical reports,¹⁰ investigation of consumer complaints made against a warranty association,¹¹ and observation of a warranty association’s compliance with monetary reserve requirements.¹²

Motor Vehicle Service Agreement Companies

Motor vehicle service agreement companies are a type of warranty association that sell motor vehicle service agreements (warranties), also known as extended vehicle warranties. There are 90 motor vehicle service agreement companies currently licensed by the OIR in Florida.¹³

Motor Vehicle Service Agreements

Motor vehicle service agreements indemnify the service agreement holder (owner) of the motor vehicle listed on the service agreement contract from losses caused by the failure or improper function of any mechanical or other component part arising out of the ownership, operation, and use of the motor vehicle.¹⁴ The five specific types of motor vehicle service agreements included under the definition of a motor vehicle service agreement are those that provide for:

² Section 634.301, F.S.

³ Section 634.401, F.S.

⁴ Florida Department of Financial Services, *Motor Vehicle Service Agreements Overview*, available at <http://www.myfloridacfo.com/Division/Consumers/UnderstandingCoverage/MotorVehicleServiceAgreementsOverview.htm> (last visited Mar. 21, 2017).

⁵ Section 634.023, F.S. Kenneth E. Spahn, *Service Warranty Associations: Regulating Service Contracts as “Insurance” Under Florida’s Chapter 634*, 25 Stetson Law Rev. 597, 614-615, available at <http://www.stetson.edu/law/lawreview/media/service-warranty-associations-regulating-service-contracts-as-insurance-under-floridas-chapter-634-25-3.pdf> (last visited Mar. 22, 2017).

⁶ Section 634.121(11), F.S.

⁷ Sections 634.023, 634.3025, and 634.4025, F.S.

⁸ Sections 634.041 and 634.061-634.081, F.S.

⁹ Section 634.1213, F.S.

¹⁰ Section 634.137, F.S.

¹¹ Section 634.141(2)(c), F.S.

¹² Section 634.141(2)(d), F.S.

¹³ Florida Office of Insurance Regulation, *Active Company Search*, available at <http://www.floir.com/CompanySearch/>, Select “Motor Vehicle Service Agreement Company” under “Company Type” (last visited March 21, 2017).

¹⁴ Section 634.011(8), F.S.

- Coverage issued in conjunction with an additive product¹⁵ that is applied to the motor vehicle;
- Payment of vehicle protection expenses, contingent upon the use of a vehicle protection product (product or system designed to prevent theft, or assist in recovery of the motor vehicle);
- Repair or replacement of tires on a motor vehicle that is damaged as a result of a road hazard;
- Indemnification of the consumer for paintless dent-removal services; and
- Replacement of a motor vehicle's key or key fob, if the key or fob is inoperable, lost, or stolen.¹⁶

Licensure

The OIR licenses and supervises motor vehicle service agreement companies under part I of ch. 634, F.S. To become licensed by the OIR, a motor vehicle service agreement company must:¹⁷

- Prove that it is a financially solvent corporation formed under Florida or another state's law;
- Establish that the corporation's management is competent and trustworthy;
- Deposit \$200,000 with the Department of Financial Services (DFS) to ensure that the corporation will meet its warranty obligations;¹⁸
- Have and maintain at least \$500,000 in net assets, which must be kept in the United States;
- Respond, under oath of two executive officers, to any inquiries made in writing by the OIR regarding the corporation's transactions and affairs; and
- Have not violated any requirement of part I of ch. 634, F.S., or any related rules, within the previous 3 years.¹⁹

Financial Health

To ensure that motor vehicle service agreement companies will be able to pay out on claims made against the warranties they issue, the OIR also requires as a qualification for licensure that all motor vehicle service agreement companies either maintain an unearned premium reserve,²⁰ or obtain contractual liability insurance on 100 percent of its warranty claim exposure.²¹ An unearned premium reserve is a cache of unencumbered assets held by the motor vehicle service agreement company that may be used to pay an unusual number of warranty claims made against the company.²² Contractual liability insurance is an insurance policy that the motor vehicle service agreement company may purchase to cover any claims or cancellation refunds that the

¹⁵ Section 634.011(2), F.S., defines an "additive product" as "any fuel supplement, oil supplement, or any other supplement product added to a motor vehicle for the purpose of increasing or enhancing the performance or improving the longevity of such motor vehicle."

¹⁶ Section 634.011(8), F.S.

¹⁷ Section 634.041, F.S.

¹⁸ *See*, s. 634.052, F.S. If the company maintains less than \$750,000 in unearned gross premium, the deposit may be lowered to \$100,000. The Department of Financial Services may also lower the required deposit to no less than \$100,000 after the first year of business. For good cause shown after notice and a hearing, the OIR may require the deposit to be increased to no more than \$500,000 to protect the company's customers and creditors. The deposit must be in the form of the various securities specified in s. 625.52, F.S.

¹⁹ Section 634.041(5), F.S.

²⁰ Section 634.041(8)(a), F.S.

²¹ Section 634.041(8)(b), F.S.

²² *See* ss. 634.011(18), .041(8)(a), F.S.

company cannot pay in the event of an unusual number of warranty claims.²³ Currently, s. 634.041(8)(b), F.S., requires such insurance policies to be purchased exclusively from an insurer that is approved by the OIR to do business in Florida, which must have \$4 million in its reserves.²⁴

However, motor vehicle service agreement companies that provide warranties that promise “vehicle protection expenses,” or a flat amount payable to the agreement holder upon the loss or damage to the vehicle, are not given a choice regarding how they may cover their claim exposure.²⁵ These companies are required to maintain a contractual liability insurance policy on 100 percent of their warranty claim exposures; they may not use an unearned premium reserve.²⁶ Additionally, these companies must obtain their insurance from an insurer who is not affiliated with their company, unless the insurer issued the policy to the company before January 1, 2002.²⁷

Cancellation of Motor Vehicle Service Agreements

Currently, an agreement purchaser, insurer, or service agreement company are authorized under conditions specified by law to cancel a motor vehicle service agreement, depending on the length of time since the purchase of the service agreement.²⁸ An agreement holder must positively act to cancel his or her service agreement after he or she satisfies the vehicle financing, through either sale, trade-in, or pay-off of the vehicle following an insured total loss; cancellation of the warranty does not automatically occur. Cancellation allows the agreement holder to avoid unnecessary premiums and to obtain a refund of a portion of the premium paid, as provided by law.^{29, 30} In current practice, some service agreement lenders, finance companies, or creditors request the cancellation of a service agreement on behalf of a consumer when the agreement is no longer necessary, but this is not expressly permitted in law.

Warranties under the Uniform Commercial Code

Extended warranty motor vehicle service agreements are distinct from the basic manufacturer’s warranty traditionally offered by motor vehicle manufacturers. A basic motor vehicle warranty is generally provided for in Florida’s Uniform Commercial Code,³¹ which defines a warranty as any writing or promise made by the vehicle manufacturer that relates to the nature of the material

²³ Contractual liability insurance is casualty insurance. Section 624.605(1)(b), F.S. Casualty insurers are initially required to have at least \$5,000,000 in surplus as to policyholders and subsequently must maintain \$4,000,000 in surplus as to policy holders. Sections 624.407 and 624.408, F.S.

²⁴ Section 624.408(1)(e), F.S.

²⁵ Section 634.011(8)(b), F.S.

²⁶ Section 634.041(11)(a), F.S.

²⁷ *Id.*

²⁸ Section 634.121, F.S.

²⁹ Section 634.121(3), F.S. This section also governs cancellations by the service agreement company and provides detailed requirements concerning justification and process.

³⁰ “Unearned premium” is the portion of the gross written premium that has not been earned on a straight pro rata basis. Section 634.011(16), F.S. Premium is not earned until the policy period expires and are usually paid in advance. Unearned premium is that portion of a premium that the insurer has already received, but relates to future coverage during the policy period.

³¹ See ch. 681, F.S., “Motor Vehicle Warranty Enforcement Act.”

or workmanship of the vehicle, and affirms or promises that such material or workmanship is free of defects.³²

Basic warranties are not considered insurance for several reasons, namely because they are a product given to the consumer for no extra cost, and because warranties only cover defects that are under the manufacturers' control, whereas insurance or service agreements are separate contracts that indemnify consumers against harm or loss unrelated to defects found in the vehicle.³³ As a result, basic warranties are regulated by the Florida Attorney General's Office,³⁴ and the Federal Trade Commission.³⁵

Risk Retention Groups

State and federal laws authorize risk retention groups (groups).³⁶ Federal law generally preempts their regulation but for requirements that relate to the formation and operations of the groups.³⁷ Specifically, the Federal Liability Risk Retention Act³⁸ provides that a state has primary regulatory oversight of the groups to which it issues charters. While some groups are chartered under s. 627.943, F.S., and are therefore regulated by the OIR, other groups are chartered in foreign states and are therefore subject to those states' regulatory authority. Despite this, all groups that are chartered by any state, and that meet the requirements of the Federal Liability Risk Retention Act, may operate as a group in Florida.^{39,40} There are 108 risk retention groups active in Florida.⁴¹

Risk retention groups are corporations or limited liability associations that are certified or licensed as a liability insurance company, and that operate with the primary purpose of sharing any liabilities of the members of the group among the members themselves. The true hallmark of a risk retention group, however, is that its members⁴² must engage in similar businesses or activities, and those similar interests must constitute the exposed risk that the group seeks to insure.

³² Section 681.102(22), F.S.

³³ Kenneth E. Spahn, *Service Warranty Associations: Regulating Service Contracts as "Insurance" Under Florida's Chapter 634*, 25 Stetson Law Rev. 597, 610-614, available at <http://www.stetson.edu/law/lawreview/media/service-warranty-associations-regulating-service-contracts-as-insurance-under-floridas-chapter-634-25-3.pdf> (last visited Mar. 23, 2016).

³⁴ Section 681.102(6), F.S.

³⁵ 15 U.S.C. §2302; United States Federal Trade Commission, *Consumer Information: Warranties*, available at <http://www.consumer.ftc.gov/articles/0252-warranties> (last visited Mar. 23, 2016).

³⁶ 15 U.S.C. ss. 3901, et seq. (2016); part XIX of ch. 627, F.S., "Purchasing Groups and Risk Retention Groups."

³⁷ 15 U.S.C. s. 3902 (2016).

³⁸ 15 USC §3901.

³⁹ Fla. Admin. Code R. 69-O-200.006, requires insurers who write contractual liability insurance to obtain a certificate of authority from the OIR to do so. The OIR asserts that risk retention groups from outside of Florida may not receive certificates of authority under current law, and therefore the groups cannot offer contractual liability insurance in Florida. Florida Office of Insurance Regulation, *Agency Analysis of 2017 Senate Bill 794*, p. 5 (Feb. 17, 2017). This rule may conflict with federal preemption regarding risk retention groups and could be resolved by the bill.

⁴⁰ Section 627.944, F.S.

⁴¹ Florida Office of Insurance Regulation, *Active Company Search*, <http://www.floir.com/CompanySearch/>, Select "Risk Retention Group" under "Company Type" (last visited March 23, 2017).

⁴² Section 627.942(9)(e), F.S. requires that risk retention groups be owned by either their members, who must also receive insurance from the group, or by an organization made up of members who receive insurance from the group.

Risk retention groups may only insure specific risks: liability insurance, and reinsurance of other risk retention groups that share the same common interests required to form a group. Benefits of membership in a risk retention group include better control of overhead costs and profits, higher standards of underwriting, and stability of coverage.⁴³ The availability of participation in risk retention groups provide business with another option to compete in the market.

III. Effect of Proposed Changes:

Section 1 amends s. 634.041, F.S., to revise how motor vehicle service warranty companies may obtain contractual liability insurance to cover their claim exposure. Specifically, it allows motor vehicle service warranty companies to meet their reserve requirements by participating in a risk retention group, if the group covers 100 percent of the claims exposure of the company, and maintains net assets (surplus as regards policyholders) of at least \$15 million. Additionally, the bill makes the \$15 million minimum surplus as regards policyholders uniformly apply to both risk retention groups and insurers that provide claims coverage for a motor vehicle service agreement company; this represents an increase from a \$4 million surplus as regards policyholders requirement previously applied to such insurers.

Motor vehicle service warranty companies that offer vehicle protection expenses may opt to meet their reserve requirements through risk retention groups, rather than exclusively through traditional insurers. The bill also permits these specific warranty companies to purchase their claim insurance through an insurance company that is affiliated with their business.

Section 2 amends s. 634.121(3)(b), F.S., to authorize additional parties, specifically the lender, finance company, or creditor, to cancel a motor vehicle service agreement. However, these parties may only do so 60 days or more after the motor vehicle service agreement was purchased, and where such a right of cancellation is expressly provided for in the contract.

Section 3 of the bill provides an effective date of July 1, 2017.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

⁴³ Golden Insurance Company, *Risk Retention Group FAQ's*, <http://www.golden-insurance.com/FAQS> (last visited Mar. 22, 2017); Captive Insurance Companies Association, *Risk Retention FAQ's: What are the advantages of risk retention groups?*, <http://www.cicaworld.com/Resources/risk-retention-faqs> (last visited Mar. 22, 2017).

V. Fiscal Impact Statement:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

Insurers and risk retention groups providing contractual liability coverage on motor vehicle service warranties will need to maintain a surplus of at least \$15 million dollars.

The bill may increase the amount of and options related to contractual liability coverage of motor vehicle service agreements.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends ss. 634.041, and 634.121, F.S.

IX. Additional Information:**A. Committee Substitute – Statement of Substantial Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Banking and Insurance on March 14, 2017:

- Makes technical and grammatical changes to the provision of the bill; and
- Allows a lender, finance company, or creditor to cancel service agreements, if provided for in the underlying agreement.

B. Amendments:

None.