SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: SB 482

SPONSOR: Senator Pruitt

SUBJECT: Statutory Accounting Principles

DATE: April 19, 2001 REVISED: 04/24/01

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	Fav/1 amendment
2.				
3.				
4.				
5.				
6.				

I. Summary:

The bill would adopt uniform, statutory accounting principles, as defined in the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual, effective January 1, 2001, and provide conforming changes to the accounting provisions of the Insurance Code for insurers and health maintenance organizations.

According to the National Association of Insurance Commissioners, 32 states reference the Accounting Practices and Procedures Manual in their statutes, and 12 require the use of the manuals by name in regulation.

This bill substantially amends the following sections of the Florida Statutes: 625.011, 625.012, 625.031, 625.041, 625.141, 625.161, 641.19, and 641.35.

II. Present Situation:

According to the National Association of Insurance Commissioners (NAIC), statutory accounting principles are the accounting principles or practices prescribed or permitted by an insurer's domiciliary state. Statutory accounting principles attempt to determine at the financial statement date an insurer's ability to meet its obligations to its policyholders and creditors. Statutory accounting principles are designed to address the concerns of regulators, who are the primary users of statutory financial statements. Statutory policy reserves are intentionally established on a conservative basis emphasizing the long-term nature of liabilities.

In contrast, generally accepted accounting principles (GAAP) are designed to meet the varying needs of different users of financial statements. Generally accepted accounting principles emphasize the measurement of emerging earnings of a business from period to period.

According to the National Association of Insurance Commissioners, the purpose of the Codification of Statutory Accounting Principles project was to produce a comprehensive guide to statutory accounting for use by insurance departments, insurers, and auditors. Statutory accounting principles, as they existed prior to codification did not always provide a consistent and comprehensive basis of accounting and reporting. The prescribed or permitted statutory accounting model resulted in practices that periodically varied from state to state. Insurance companies were sometimes uncertain about what rules to follow and regulators were at times unfamiliar with the accounting rules followed by insurers in other states. As a result, insurers' financial statements were not always prepared on a comparable and consistent basis.

According to the National Association of Insurance Commissioners, 32 states reference the Accounting Practices and Procedures Manual in their statutes, and 12 require the use of the manuals by name in regulation.

Presently, the Insurance Code, part I of the ch. 641, F.S., relating to accounting for health maintenance organizations, and rules adopted by the department require financial statements and annual reports to be prepared in accordance with statutory accounting principles. Section 626.043, F.S., requires each prepaid limited health service organization to file financial statements in accordance with statutory accounting principles. Statutory accounting principles for multiple-employer welfare arrangements are defined in s. 625.4361, F.S., to mean generally accepted accounting principles, except as modified by part I of ch. 625, F.S., and by rules adopted by the Department of Insurance which recognize the difference between a multiple-employer welfare arrangement and an insurer. Section 641.19, F.S., defines statutory accounting principles for a health maintenance organizations to mean generally accepted accounting principles, except as modified by this part.

Section 624.610, F.S., authorizes the department to adopt rules implementing provisions relating to reinsurance. Such rules are required to be in substantial compliance with the 1999 National Association of Insurance Commissioners Accounting Practices and Procedures Manual.

Rule 4-137.001, F.A.C., relating to quarterly and annual reporting requirements, requires authorized insurers to submit financial statements prepared in accordance with the NAIC's Accounting Practices and Procedures Manual for Property and Casualty, 1998 edition, and the NAIC's Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, 1999 edition. Rule 4-190.059, F.A.C., relating to rules for self-insurers funds, requires annual financial statements to be prepared in accordance with NAIC's Accounting Practices and Procedures Manual, 1993 edition.

III. Effect of Proposed Changes:

Section 1. Amends s. 625.011, F.S., to define the term, "statutory accounting principles," to mean accounting principles adopted by the National Association of Insurance Commissioners Accounting Practices and Procedures Manual, effective January 1, 2001.

Surplus notes are defined to mean financial instruments that are subject to strict control by the Department of Insurance of the reporting entity's state of domicile and that have been approved by the department as to form and content.

Section 2. Amends s. 625.012, F.S., to revise definitions of assets that are authorized to be recognized and used in determining the financial condition of an insurer.

Cash equivalents are defined to mean short-term, highly liquid investments, with a maturity of 3 months or less, which are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of change in value because of interest rates.

The definition of "electronic and mechanical machines" is revised to include computer operating software. The aggregate amount admitted under this subsection would be limited to 3 percent of the insurer's capital and surplus, adjusted to exclude any electronic data processing equipment and operating software, net deferred tax assets, and net positive goodwill, as reported on the insurer's recently filed annual statement.

Goodwill arising from acquisitions and mergers occurring after January 1, 2001 would now be considered an asset. Goodwill would be calculated as the difference between the cost of acquiring an entity and the acquiring or surviving entity's share of the book value of the acquired entity. Insurers would be able to recognize and record goodwill of up to 10 percent of the reporting entity's capital and surplus reported on its recently filed annual statement, adjusted to exclude any electronic data processing equipment and operating software, net deferred tax assets, and net positive goodwill, as reported on the insurer's recently filed annual statement.

Loans and advances by an insurer to its parent or principal owner could be included as an asset, if approved by the Department of Insurance. Loans or advances by an insurer to all other related parties would be allowed, if the transaction constitutes an arm's length transaction or economic transaction.

Deferred tax assets and liabilities resulting from the expected future tax consequences of temporary differences attributed to statutory accounting principles would be allowed, subject to certain limitations.

Insurers would also be able to recognize current income tax recoverables and capitalized interest as assets.

Section 3. Amends s. 625.031, F.S., to revise the types of assets that could not be used in determining the financial condition of the insurer. Patents and agreements that do not compete are added to the list of such assets. Goodwill is eliminated since it would be allowed to be used as an admitted asset under section 2 of the bill.

Section 4. Amends s. 625.041, F.S., to revise the lists of liabilities that are required to be charged against assets in determining the financial condition of an insurer. The definition of "reserves" is revised to include contract and premium deficiency reserves.

Section 5. Amends s. 625.141, F.S., to specify the methodology for amortizing bond premiums and discounts. An insurer would be required to use the constant yield or scientific interest method, taking into consideration specified interest and principal provisions over the life of the bond.

Section 6. Amends s. 625.161, F.S., relating to valuation of real property, to allow the Department of Insurance to require a new appraisal for the valuation of real property, if the appraisal that it is based upon is more than 5 years old. Presently, the department may require a new appraisal if the appraisal that is relied upon is more than 3 years old.

Section 7. Amends s. 641.19, F.S., relating to accounting for health maintenance organizations, to revise definitions. The term, "reporting period," would be revised to mean the annual calendar year or any part thereof, rather than the annual accounting period or the fiscal year of the health maintenance organization.

The definition of statutory accounting principles is revised to reflect the codification of the 2001 NAIC Accounting Practices and Procedures Manual. Presently, statutory accounting principles means generally accepted accounting principles, except as modified by this part.

The definition of surplus is revised to total statutory assets in excess of total liabilities, except that assets pledged to secure debts of the health maintenance organization would not be included in surplus. Presently, assets pledged to secure debts not reflected on the books of the health maintenance organization are not included in surplus.

The definition of "surplus notes" is revised. See section 1 for a summary of the change.

Section 8. Amends s. 641.35, to revise accounting for assets and liabilities of health maintenance organization. See section 1 of the Proposed Changes for the definitions of cash equivalents, goodwill, loans and advances, deferred taxes and liabilities, and capitalized interest, which would be considered allowable or admitted assets for the purposes of determining a health maintenance organization's financial condition.

Rent due or accrued on real property and the unaccrued portion of taxes paid prior to the due date on real property are eliminated from the definition of admitted assets for purposes of determining a health maintenance organization's financial condition.

The liquidation value of prepaid expenses, furniture, fixtures, vehicles, medical libraries, and equipment (if the original cost of each item is at least $200) are eliminated from the list of admitted assets. All furniture, fixtures, furnishings, vehicles, medical libraries, and equipment would be considered nonadmitted assets. Presently, if the original cost of each of these items exceeded $200, it was considered an admitted asset.

Conforming changes are made to the nonadmitted assets, or assets not allowed for purposes of determining the financial condition of a health maintenance organization to eliminate goodwill and loans and advances to parent companies. Under the provisions of the bill, goodwill and loans and advances to parent companies would be considered admitted assets.

The definition of liabilities would be revised to include contract and premium deficiency reserves.

Section 9. Provides that this act would take effect upon becoming law and would apply retroactively to January 1, 2001.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Representatives for smaller, health maintenance organizations have indicated that the immediate implementation of the new statutory accounting principles would result in a significant negative impact on the financial condition of these HMOs, since the new accounting principles would no longer allow the inclusion of certain assets (e.g., furniture, fixtures, furnishings, equipment, medical libaries) or would limit the amount of inclusion of certain assets (computer software) for the purposes of calculating the financial condition of the HMO.

Accounting guidance for the industry and auditors will be more effective and consistent, as all such requirements would be contained within a single NAIC volume.

C. Government Sector Impact:

The new Accounting Practices and Procedures Manual would result in more complete disclosures and more comparable financial statements, which will make the Department of Insurance's analysis techniques more meaningful and effective, which in turn increases policyholder protection. The manual would provide examiners and analysts with uniform accounting rules against which companies' financial statements can be evaluated. Risk-based capital, an important tool used by the states to measure solvency of insurers, would be reported more consistently with the benefit of codification of the accounting practices and procedures.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

#1 by Banking and Insurance:
The delete everything amendment adopts uniform, statutory accounting principles, as defined in the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual, effective January 1, 2001, and provides conforming changes to the accounting provisions of the Insurance Code for insurers and health maintenance organizations. The amendment also provides that sections 9 and 10, relating to health maintenance oganizations, would be effective January 1, 2003, and all other provisions of the bill are effective upon becoming law and apply retroactively to January 1, 2001. (WITH TITLE AMENDMENT)