

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: CS/SB 1848

SPONSOR: Commerce, Economic, Opportunities, and Consumer Services Committee and Senator Bennett

SUBJECT: Warranty Associations

DATE: March 15, 2004 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Cibula</u>	<u>Maclure</u>	<u>CM</u>	<u>Fav/CS</u>
2.	<u>Deffenbaugh</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable</u>
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

Committee Substitute for Senate Bill 1848 authorizes a sales representative who sells motor vehicle service agreements, home warranties, or service warranties for consumer products to offer rebates of his or her sales commission to consumers. The rebate amount must be in accordance with a schedule that is prominently displayed in the sales representative’s office. The sales representative must offer the same rebate to all similarly situated individuals.

The bill also provides that a service warranty association is not required to maintain an unearned premium reserve or contractual liability insurance and may allow its premiums to net assets ratio to exceed 7-to-1 if:

- the association has a net worth of at least \$100 million; or
- the association maintains at least \$750,000 in net assets and is a wholly owned subsidiary of a parent corporation with a net worth of at least \$100 million which guarantees the performance of the warranty obligations of the association.

This bill substantially amends section 634.406 of the Florida Statutes.

The bill creates the following sections of the Florida Statutes: 634.1815, 634.3205, and 634.4225.

II. Present Situation:

Warranty Associations

Warranty associations are regulated by the Office of Insurance Regulation (OIR) under ch. 634, F.S., and include motor vehicle service agreement companies, home warranty associations, and service warranty associations. However, the Department of Financial Services is authorized to regulate the salespersons and representatives who sell warranties (as part of the department's authority to license and regulate insurance agents).

Motor vehicle service agreement companies sell motor vehicle service agreements that indemnify a service agreement holder for a motor vehicle against loss caused by failure of any mechanical or other component part that does not function as it was originally intended.¹ Motor vehicle service agreement companies are regulated exclusively under part I, ch. 634, F.S., except as otherwise provided in that part.² Motor vehicle service agreement companies must file their rates and premiums with OIR, but they are not subject to disapproval by OIR.³

Home warranty associations sell home warranties that indemnify a warranty holder against the cost of repair or replacement of any structural component or appliance of a home necessitated by wear and tear or an inherent defect.⁴ Home warranty associations are regulated exclusively under part II, ch. 634, F.S., except as otherwise provided in that part.⁵ Home warranty associations must file their rates and premiums with OIR for informational purposes.⁶

Service warranty associations sell service warranties that indemnify a warranty holder against the cost of repair or replacement of a consumer product.⁷ Service warranty associations are regulated exclusively under part III, ch. 634, F.S., except as otherwise provided in that part. There is no statutory requirement for service warranty associations to file their rates and premiums with OIR.

Unlawful Rebates

For motor vehicle service agreements, the law prohibits paying, allowing, giving, or offering any unlawful rebate of premiums payable on the agreement as an inducement for the purchase of a motor vehicle service agreement.⁸ An unlawful rebate may include paying, giving, selling, or purchasing something as an inducement for the purchase of a motor vehicle service agreement.⁹ A related provision prohibits knowingly collecting, as a premium or charge for a motor vehicle service agreement, any sum in excess of or less than the premium or charge applicable to such agreement, in accordance with the rates filed with OIR.¹⁰ The law further provides that a

¹ Section 634.011(7), F.S.

² Section 634.023(1), F.S.

³ Section 634.1216, F.S.

⁴ Section 634.301(3), F.S.

⁵ Section 634.3025(1), F.S.

⁶ Section 634.3126, F.S.

⁷ Section 634.401(13), F.S.

⁸ Section 634.282(7), F.S.

⁹ *Id.*

¹⁰ Section 634.282(13), F.S.

salesperson who engages in unlawful rebating is subject to compulsory suspension or revocation of his or her license or appointment.¹¹

There is no prohibition against unlawful rebates by a sales representative for a home warranty association or service warranty association in parts II and III, ch. 634, F.S. Nevertheless, statutes in parts II and III, ch. 634, F.S., authorize the office to revoke the license of a sales representative of a home warranty association or a service warranty association who makes an unlawful rebate.¹²

Some anti-rebate statutes have been reviewed by courts to determine whether they are unconstitutional in violation of the due process clause in s. 9, Art. I, Florida Constitution. In *Department of Insurance v. Dade County Consumer Advocate's Office*, 492 So. 2d 1032 (Fla. 1986), the Department of Insurance argued that certain anti-rebate statutes were constitutional because:

- the statutory ban against insurance commission rebates is rationally related to the state interest by guaranteeing insurer solvency and the prevention of discrimination among insureds of the same actuarial class;¹³ and
- the agent who is permitted to rebate will do so at the expense of his customers, in that they will not be provided with the quality of information regarding the best type of insurance suited to their needs because the agent, having negotiated his commission, will not spend the requisite time counseling his clients.¹⁴

In rejecting the arguments of the Department of Insurance, the Court found:

no identifiable relationship between the anti-rebate statutes and a legitimate state purpose in safeguarding the public health, safety or general welfare. Insurance agents' commissions do not affect the net insurance premium and are unrelated to the actuarial soundness of insurance policies.¹⁵

Similarly, in *Chicago Title Insurance Co., v. Butler*, 770 So. 2d 1210 (Fla. 2000), the Court determined whether statutes that prohibited title insurance agents from rebating their commissions were constitutional. The statutes reviewed by the Court guaranteed 30 percent of the risk premium for title insurance to title insurers to ensure their solvency.¹⁶ As a result, the Court rejected the argument that anti-rebate statutes were necessary to ensure the solvency of title insurers.¹⁷ The Court ultimately held that the anti-rebate statutes at issue were

¹¹ Section 634.181(9), F.S.

¹² Sections 634.320(9) and 634.422(9), F.S.

¹³ *Dade County Consumer Advocate's Office v. Department of Insurance*, 457 So. 2d 495, 497 (Fla. 1st DCA 1984), *aff'd*, 492 So. 2d 1032 (Fla. 1986), and *see Department of Insurance v. Dade County Consumer Advocate's Office*, 492 So. 2d 1032, 1033-1034 (Fla. 1986).

¹⁴ *Id.*

¹⁵ *Department of Insurance v. Dade County Consumer Advocate's Office*, 492 So. 2d 1032, 1035 (Fla. 1986).

¹⁶ *Chicago Title Insurance Co., v. Butler*, 770 So. 2d 1210, 1218 (Fla. 2000).

¹⁷ *Id.*

unconstitutional because they harm the public and violate a citizen's property rights to freely negotiate the cost of services from a provider.¹⁸

After the decision in *Department of Insurance v. Dade County Consumer Advocate's Office*, 492 So. 2d 1032 (Fla. 1986), the Legislature adopted s. 626.572, F.S., to clarify the circumstances under which rebates of commissions are permitted by insurance agents.¹⁹ Under s. 626.572, F.S., rebates must be available pursuant to a rebate schedule that is prominently displayed in an insurance agent's office. These rebates must be available to all similarly situated clients of the insurance agent. An insurance agent may not offer a rebate if the insurer that the agent represents prohibits rebates.

Section 626.572, F.S., however, does not permit a service representative for a warranty association to rebate his or her commission because warranty associations are regulated almost exclusively under ch. 634, F.S. No provision exists to authorize a sales representative for warranty association to rebate his or her sales commission.

Financial Requirements

Under s. 634.406, F.S., a service warranty association must have a method to ensure that the association has the resources to satisfy claims on its service warranties. These methods include an unearned premium reserve or contractual liability insurance. Also, an association must not allow its gross written premiums in force to exceed a 7-to-1 ratio to net assets, and the association must maintain a minimum amount of net assets or a contractual liability policy.

An unearned premium reserve is an authorized method by which a service warranty association may ensure that it is able to fulfill warranty claims. Using an unearned premium reserve, a service warranty association will hold aside a certain percentage of the premiums it receives in an unearned premium reserve account.²⁰ A service warranty association that uses an unearned premium reserve must also make a reserve deposit with the Office of Insurance Regulation in an amount equal to 10 percent of the gross written premiums for all warranty contracts in force.²¹

A service warranty association that does not maintain the unearned premium reserve described above must maintain a contractual liability insurance policy that will cover 100 percent of its claim exposure.²² The insurer issuing a contractual liability insurance policy must agree to take over the administration of claims and payment of refunds from the warranty association.

Generally, a service warranty association must not allow its gross written premiums in force to be more than a 7-to-1 ratio to its net assets.²³ The term "net assets" means total statutory assets in excess of liabilities, except that assets pledged to secure debts not reflected on the books of the

¹⁸ See *id.* at 1219 and 1221.

¹⁹ See House of Representatives Committee on Insurance, *Final Staff Analysis & Economic Impact Statement of CS/HB 3621*, at 10 (July 11, 1990).

²⁰ Section 634.406(1), F.S.

²¹ Section 634.406(2), F.S.

²² Section 634.406(3), F.S.

²³ Section 634.406(4) and (5), F.S.

service warranty association shall not be included in net assets.”²⁴ The net assets of a service warranty association include cash, certain investments, certain items of personal property, inventories, and the liquidation value of prepaid expenses.²⁵ The net assets of a service warranty association do not include goodwill; patents; debts owed by officers, directors, or controlling shareholders to the association; or stock of the association.²⁶

III. Effect of Proposed Changes:

Rebates

Committee Substitute for Senate Bill 1848 authorizes a salesperson or sales representative who sells motor vehicle service agreements, home warranties, or service warranties for consumer products to offer rebates of his or her sales commission to consumers. The rebate amount must be in accordance with a schedule that is prominently displayed in the sales representative’s office. The sales representative must offer the same rebate to all similarly situated individuals.

The provisions of the bill that authorize a sales representative of a warranty association to make a rebate of the sales representative’s commission to a consumer are similar to the provisions of s. 626.572, F.S., that authorize an insurance agent to make a rebate of the insurance agent’s commission. The provisions of the bill, however, do not include a provision that prohibits a sales representative of a warranty association from making a rebate of the sales representative’s commission if the warranty association prohibits rebates.

Service Warranty Association Financial Requirements

The bill also establishes a new method by which certain service warranty associations may ensure that they have the resources to satisfy warranty claims. Under the new method, a service warranty association may be exempt from the current requirements to have an unearned premium reserve or contractual liability insurance and may allow its premiums to net assets ratio to exceed 7-to-1 if:

- the association has a net worth of at least \$100 million; or
- the association maintains net assets of \$750,000 and is a wholly owned subsidiary of a parent corporation that has a net worth of at least \$100 million and guarantees the service warranty obligations of the association.

If the obligations of a service warranty association are secured by the guarantee of the parent, the parent corporation may cancel or modify the guarantee only if it notifies the Office of Insurance Regulation at least 90 days before the effective date of the notice and the office approves the cancellation or modification. To receive approval, the association must demonstrate that it is in compliance with part III, ch. 634, F.S., including an adequate unearned premium reserve or contractual liability insurance. If an association does not demonstrate compliance with all applicable provisions of part III, ch. 634, F.S., the association must cease new and renewal business upon the effective date of the cancellation or modification of the guarantee.

²⁴ Section 634.401(9), F.S.

²⁵ Section 634.4061(1), F.S.

²⁶ Section 634.4061(2), F.S.

To demonstrate that an association or parent corporation continuously maintains a net worth of at least \$100 million, the association or corporation must submit copies of the following documents to the office: audited annual financial statements, quarterly certifications of net worth, and annual and quarterly reports required to be filed with a “recognized stock exchange.” The term “recognized stock exchange” is not defined by the bill. Nor does the bill identify who or what is authorized to recognize an exchange. Failure to timely file the required documents with the Office of Insurance Regulation may be grounds to revoke the license of the service warranty association.

The association or parent corporation with the net worth of at least \$100 million must also maintain its outstanding debt obligations, if any, rated in the top four rating categories by a recognized rating service. The term “recognized rating service” is not defined by the bill. Nor does the bill identify who or what is authorized to recognize a rating service.

The bill takes effect upon becoming a law.

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:

The bill authorizes a salesperson or sales representative for a motor vehicle service agreement company, home warranty association, or service warranty association to rebate his or her commission to a consumer.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
