

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/CS/SB 2270

SPONSOR: Appropriations Subcommittee on General Government and Banking and Insurance Committee

SUBJECT: Workers' Compensation Joint Underwriting Association

DATE: April 14, 2004

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable/CS</u>
2.	<u>Kynoch</u>	<u>Hayes</u>	<u>AGG</u>	<u>Favorable/CS</u>
3.	_____	_____	<u>AP</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The Committee Substitute provides significant changes to the Florida Workers' Compensation Joint Underwriting Association (JUA) that are designed to address availability and affordability of coverage for small employers that are new businesses or have good loss experience. The bill provides a one-time appropriation of \$25 million from the Workers' Compensation Administration Trust Fund (WCATF) in the Department of Financial Services (DFS) for transfer to the JUA to fund the deficit incurred for subplan D policies of the JUA. Additionally, the bill authorizes the JUA to request from the DFS transfer of an amount not to exceed \$10 million from the WCATF to fund deficits anticipated to occur in Fiscal Year 2004-2005, subject to approval by the Legislative Budget Commission.

Eligibility and Premiums for Tiers One, Two, and Three

The bill restructures the existing JUA by eliminating the current subplans and creating three tiers with eligibility based on an employer's loss experience, effective July 1, 2004. Premiums in Tier One and Tier Two are capped at 25 percent and 50 percent of the premiums of the voluntary market, respectively, until there is sufficient experience for the JUA to establish actuarially sound rates for the tiers or no earlier than January 1, 2007. Employers in Tier Three will be charged actuarially sound rates and only these policies will be assessable meaning that policyholders could be assessed additional premiums to cover any deficits. Policyholders in all tiers are subject to a \$475 annual administrative fee.

Tier One provides coverage for employers that have an experience-rating modification factor of less than 1.0 or, if nonrated, the employers must have a continuous three-year history of workers' compensation coverage.

Tier Two provides coverage for new employers, employers with moderate experience (experience-rating modification factor equal to or greater than 1.0 but not greater than 1.10), and employers with good experience who do not have a continuous 3-year history of workers' compensation coverage.

Tier Three provides coverage for all other employers.

The JUA is required to establish actuarially sound premiums for minimum premium policies in Tiers One and Two for employers that do not employ nonexempt employees or report payroll, which is less than minimum wage for one employee for one year at 40 hours per week. However, premiums for such policies may not exceed \$2,500. This premium cap will exist until there is sufficient experience for the JUA to establish actuarially sound rates for Tiers One and Two or no earlier than January 1, 2007.

Funding for Deficits in the JUA

In the event a deficit exists in Tier One, Tier Two, or a deficit attributable to former subplan D remains after the \$25 million appropriation to the JUA, the JUA is authorized to request from the DFS transfer of an amount not to exceed \$10 million from the WCATF subject to approval by the Legislative Budget Commission. Any remaining deficit would be funded by a "below-the-line" assessment on all workers' compensation policies in the voluntary market for a period of 1 year. Subplan D policyholders would not be subject to assessments for the funding of any deficits.

Other Provisions

The bill exempts the JUA from the premium tax and assessments for the WCATF and the Special Disability Trust Fund. The bill also provides legislative intent to create a state workers' compensation mutual fund if workers' compensation coverage is not generally available and affordable to small employers by October 1, 2005. In order to make this determination, the bill establishes the Workers' Compensation Insurance Market Evaluation Committee consisting of one member appointed by the Governor and two members appointed by each of the respective presiding officers of the Legislative Branch.

Senate Bill 50-A, enacted in the 2003 Special Session A, created subplan D in the JUA and capped premiums at 25 percent above the voluntary market premium for small employers and 10 percent above the voluntary market premium for charitable organizations meeting certain criterion.¹ These policies are assessable, meaning that any deficit in the subplan must be funded by assessing the policyholders for additional premiums. Since these capped premiums are not actuarially sound, the JUA recently reported that subplan D incurred a \$9.9 million deficit, as of December 31, 2003, and has projected a deficit of more than \$36 million as of December 31, 2004, if additional funding is not provided. Given the limited financial resources of many small employers in the subplan, the likelihood of collecting the total assessment from subplan D policyholders is doubtful.

This bill substantially amends section 627.311 of the Florida Statutes.

¹ Senate Bill 50-A, ch. 2003-412, L.O.F.

II. Present Situation:

Due to growing concerns regarding the availability and affordability of workers' compensation insurance in Florida, legislation was enacted in 2003 that substantially revised many aspects of the workers' compensation law.² Senate Bill 50-A contained provisions that were designed to reduce costs and increase the affordability and availability of coverage for small employers. Restrictions on exemptions in the construction industry, enacted by Senate Bill 50-A, were expected to increase the Florida Workers' Compensation Joint Underwriting Association (JUA) volume even further, prompting the Legislature to address affordability of JUA coverage. Because of this legislation, rates for new and renewal policies that are effective on or after October 1, 2003, were reduced by 14.0 percent in the voluntary market and the JUA.

The Florida Workers' Compensation Joint Underwriting Association

The JUA is created under s. 627.311, F.S., as a nonprofit entity. The JUA's Board is comprised of nine members consisting of three members appointed by the Financial Services Commission; two members representing the top 20 domestic insurers writing workers' compensation in Florida; two members representing the top 20 foreign insurers writing workers' compensation in Florida; one person appointed by the largest property and casualty insurance agents' association in Florida; and the consumer advocate for the Department of Financial Services.

Under Senate Bill 50-A, an employer with an experience rating modification factor of 1.10 or less and either employs 15 or fewer employees or is a charitable organization that is exempt from federal income taxes pursuant to s. 501(c)(3) of the Internal Revenue Code is eligible for subplan D. The bill caps rates for subplan D at a 25 percent surcharge and a 10 percent surcharge for small employers and certain charitable organizations, respectively.³ The JUA indicated that their premiums for subplan D should be 2.57 times higher than the voluntary market premium to remain actuarially sound; hence, projected subplan D would likely incur a deficit.

Since subplan D policies are assessable, any deficits in the subplan are to be assessed against the policyholders in that subplan. On February 27, 2004, the JUA notified the Office of Insurance Regulation (OIR) that subplan D incurred a deficit of \$9.9 million in 2003. According to the JUA's projected annual financial statements, subplan D will incur a deficit of more than \$36 million as of December 31, 2004, if no additional funding is provided. The JUA also indicated in this memorandum that it would be submitting a plan to the OIR to eliminate the deficit based on an assessment of subplan D policyholders. As of February 29, 2004, there were 2,534 policyholders in subplan D. The JUA is required to file this plan within 90 days of the deficit notification. The collection of the full amount of any such assessments is doubtful, given the limited financial resources of many small employers, as well as the history of largely unsuccessful attempts at collecting assessments from members of insolvent group self-insurance funds.

According to the OIR, the JUA may recognize a statutory deficit by the filing of any quarterly or annual financial report.⁴ Each authorized insurer, including the JUA, is required to submit the

² Id.

³ JUA Subplan D Rate Filing to Implement Senate Bill 50-A, dated June 27, 2003.

⁴ Memorandum from Kevin McCarty, Director of the Office of Insurance Regulation, dated February 11, 2004.

annual statement and the audited financial report for the prior year to the OIR by March 1 and June 1, respectively.⁵ In addition, the JUA is required to submit an independent actuarial certification of the JUA's operation for the prior year by June 1 of each year. If the expenses exceed the income for prior years, the certification is subject to review and approval by the OIR before it is finalized. Section 627.311(5), F.S., provides two mechanisms for triggering an assessment. First, the JUA is authorized to levy an assessment against subplan D policyholders, subject to verification by the OIR. The section also provides that whenever a deficit exists, as documented by an actuarial report or other communication from the JUA, the JUA must submit a program to the OIR within 90 days that eliminates the deficit within a reasonable period. The law provides that such a program could include a proposed assessment or increased premiums; however, the premiums are capped in subplan D.

Because of the creation of subplan D and the caps on premiums, ongoing concerns exist regarding the financial impact of subplan D on the JUA, the magnitude of the statutory deficit and policyholder assessments associated with the subplan, and any resultant solvency issues. The Senate Banking and Insurance Committee staff interim report entitled, *Review of the 2003 Workers' Compensation Act*,⁶ included legislative recommendations to address the deficit in the JUA and solvency issues. The staff report recommended that the Legislature consider providing a one-time budget transfer from the Workers' Compensation Administration Trust Fund, exempting the JUA from the Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund assessments, and revising the premium structure of subplan D and the assessment methodology.

Recently, the JUA Board of Governors (Board) issued legislative recommendations to address solvency and assessment issues summarized below:⁷

Funding the Existing Deficit. The Board recommends that the Legislature consider authorizing a loan from the Workers' Compensation Administration Trust Fund (WCATF) to the JUA to fund the existing deficit in subplan D.

Caps on Rates. The Board notes that the elimination of artificial rate caps and a return to the requirement that the Board maintain actuarially sound rates in all subplans would likely return the JUA to a more stable financial condition.

Depopulation Incentives. Current law provides that voluntary market carriers may take policies out of subplan D, charging the policyholder rates no greater than the JUA rates in subplan D for a period of two years after the take-out. Policies taken out of the JUA in this manner do not count against consent to rate limitations contained in s. 627.171, F.S. The Board suggests expanding this incentive program and the current depopulation program to all JUA subplans. Additionally, the Board suggests that the two-year consent to rate moratorium be extended to five years, so that voluntary market carriers could continue to write the take-out business for five years, so long as the policyholder and the carrier are willing to continue doing business under that rating arrangement.

⁵ Section 624.424, F.S. (2003).

⁶ Interim Project Report 2004-110, issued January 2004.

⁷ Florida Workers' Compensation Joint Underwriting Association, Inc. *Statement of the Board of Governors Regarding 2004 Legislative Activities*, dated February 13, 2004.

Policyholder Subplan Election. Under current law, an employer who qualifies for subplan D must be written in subplan D, and may not voluntarily choose to participate in subplan C. The Board suggests that the Legislature consider revising the JUA law to permit eligible policyholders to choose between subplan C and subplan D.

Exemption from Certain Taxes and Assessments. The Board suggests that the Legislature consider granting an exemption to the JUA for the premium tax and assessments to the WCATF and the Special Disability Trust Fund.

Escheat Laws. Under Florida's escheat laws, if the JUA owes unearned premium, producer fees or claim payments to a policyholder, producer, claimant, or provider; and it is unable to locate the payee after making a diligent effort, then the money is remitted to the State of Florida as unclaimed property. Although a relatively small amount of money is involved, the Board suggests that the Legislature provide for an exception to the escheat laws, which would allow the JUA to retain these funds.

Other Measures. It might be important for the JUA to suggest that the Legislature also consider clarifying statutory language regarding assessments.

To assist the Legislature in further addressing the impact of the act on the JUA and the availability and affordability of coverage, the law requires the JUA to submit a report to the Legislature no later than January 1, 2005, which addresses the following issues:

- projected surpluses or deficits and possible means of providing funds to ensure solvency of the plan;
- effectiveness of the law in improving the availability of coverage in the state; and
- Legislative recommendations to improve availability of coverage in the voluntary and residual market.

Workers' Compensation Administration Trust Fund

The Workers' Compensation Administration Trust Fund was established to fund all expenses associated with administering the provisions of ch. 440, F.S.⁸ This includes funding the Division of Workers' Compensation in the Department of Financial Services and providing funding for other 440, F.S., programs administered by other agencies.⁹ The total expenses of administering ch. 440, F.S., are funded by assessing carriers writing workers' compensation, self-insurers, and commercial self-insurance funds. The assessment is capped at 2.75 percent.¹⁰ The basis of the calendar-year assessment is the net premiums collected by carriers and the amount of premiums calculated by the Department of Financial Services for self-insured employers. Presently, the assessment is 1.50 percent for calendar year 2003-2004.

⁸ Section 440.50, F.S. (2003).

⁹ The Special Disability Trust Fund created under s. 440.49, F.S., is a second-injury fund that is funded by a separate assessment on self-insured employers and carriers.

¹⁰ Section 440.51, F.S. (2003).

III. Effect of Proposed Changes:

Section 1 amends s. 627.311, F.S., to revise provisions relating to the Florida Workers' Compensation Joint Underwriting Association (JUA). The section restructures the existing JUA by eliminating the current subplans and creating three tiers based on the employers' loss experience, effective July 1, 2004.

Eligibility for Tiers One, Two and Three

Tier One provides coverage for employers that have an experience rating modification factor of less than 1.0, with no lost-time claims, and total medical-only claims not exceeding 20 percent of the premium subsequent to the experience-rating period. If an employer is nonrated, an employer would be eligible for this tier if the employer had no lost-time claims for the preceding 3-year period, total medical-only claims that did not exceed 20 percent of the premium for the same period, workers' compensation coverage for the same period, and provided the plan with a loss history generated by the prior insurer or an affidavit in the event the insurer become insolvent.

Tier Two provides coverage for employers that have an experience rating modification factor equal to or greater than 1.0 but not greater than 1.10, no lost-time claims subsequent to the experience-rating period, and total medical only-claims for the same period that did not exceed 20 percent of premium. A nonrated employer is included in Tier Two if it is a new business. An employer that has less than 3 years of loss experience for the preceding 3-year period is eligible for Tier Two if the employer had no lost-time claims for the preceding 3-year period, total medical-only claims for the preceding 3-year period that did not exceed 20 percent of the premium for the same period, and the employer is able to provide a loss history generated by the prior insurer or an affidavit if the insurer became insolvent.

Tier Three provides coverage for all other employers.

Premiums for Tiers One, Two and Three

The bill caps premiums in Tier One and Tier Two at 25 percent and 50 percent of the premiums of the voluntary market, respectively, until there is sufficient experience for the JUA to establish actuarially sound rates for the tiers, or no earlier than January 1, 2007. Employers in Tier Three will be charged actuarially sound rates and only these policies will be assessable meaning that policyholders could be assessed additional premiums to cover any deficits.

The JUA is required to establish actuarially sound premiums for minimum premium policies in Tiers One and Two for employers that employ no nonexempt employees or report payroll that is less than minimum wage for one employee for one year at 40 hours per week. However, premiums for such policies may not exceed \$2,500. This premium cap will exist until there is sufficient experience for the JUA to establish actuarially sound rates for Tiers One and Two or no earlier than January 1, 2007.

Policyholders in all tiers will also be subject to an annual fee of \$475 to cover costs of administration and fraud prevention. Currently, this fee is charged by the JUA for all subplans except subplan D. The fee may be increased by the JUA, with the approval of the Office of Insurance Regulation, pursuant to a rate filing reflecting increased costs of administration and fraud prevention.

Funding for Deficits in Tier One, Tier Two, and Subplan D

The bill provides that in the event a deficit exists in Tier One, Tier Two, or a deficit attributable to former subplan D remains after the \$25 million appropriation to the JUA, the JUA is authorized to request from the Department of Financial Services transfer of an amount not to exceed \$10 million from the Workers' Compensation Administration Trust Fund subject to approval by the Legislative Budget Commission. Any remaining deficit is to be funded through an assessment on voluntary market workers' compensation policies written in Florida. The assessment would be levied on all new and renewed workers' compensation policies for a period of 1 year following the effective date of the assessment. Insurers would be responsible for collecting this assessment from policyholders and remitting the assessment to the JUA. Insurers would be liable for all collected assessments and would treat the failure of an insured to pay an assessment as a failure to pay premium. An insurer would not be liable for uncollectible assessments.

JUA Take-Out Provisions

The bill caps premiums for risks assumed by the voluntary market at the insured's JUA premium for two years; however, the premiums could be adjusted upon renewal to reflect changes in the plan rates and the tier for which the employer would qualify upon renewal.

Exemption from Premium Tax and Chapter 440, F.S. Assessments

The JUA is exempted from the premium tax and assessments for the Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund.

Prohibition on Affiliated Persons Receiving Coverage in the Voluntary Market

The bill provides that an affiliated person of any person who is delinquent in the payment of premiums, assessments, penalties, or surcharges to the JUA is ineligible for coverage in the voluntary market. The term, affiliated person, is defined to include certain entities or persons with common ownership or control. This provision is designed to prevent persons that are delinquent in making payments to the JUA from obtaining coverage in the voluntary market through an affiliated person. The current law provides that a person who is delinquent in payments to the JUA is ineligible for coverage in the voluntary market.

Section 2 provides a one-time appropriation of \$25 million from the Workers' Compensation Administration Trust Fund (WCATF) in the Department of Financial Services (DFS) for transfer to the JUA. This appropriation is to be transferred no later than July 31, 2004. Additionally, the bill authorizes the JUA to request from the DFS transfer of an amount not to exceed \$10 million from the WCATF to fund deficits in Tiers One, Tier Two, or a deficit attributable to former subplan D subject to approval by the Legislative Budget Commission. Prior to such a request for funds, the JUA and the Office of Insurance Regulation must certify to the DFS that a deficit exists in the JUA.

Section 3 provides transitional provisions that are effective upon this act becoming a law. The section expressly states that no policy in subplan D is subject to an assessment for funding a deficit in the JUA. The section also provides that any policy issued by the JUA with an effective date between the date on which this act becomes law and June 30, 2004, would be rerated and placed in the appropriate tier and would be subject to the premiums applicable for such tier.

Policyholders in the JUA prior to the effective date of the bill would remain in their respective subplans until renewal or cancellation.

Section 4 provides legislative intent to create a state workers' compensation mutual fund if workers' compensation coverage is not generally available and affordable to small employers by October 1, 2005. In order to make this determination, the bill establishes the Workers' Compensation Insurance Market Evaluation Committee consisting of one member appointed by the Governor and two members appointed by each of the respective presiding officers of the Legislative Branch. If the Legislature determines that workers' compensation coverage is not generally available and affordable to small employers in Florida, the Legislature intends to create a state mutual fund that would compete with private insurers. It is further intended that state appropriate adequate initial capitalization for the fund and that the fund be subject to the same regulatory requirements that apply to an authorized insurer.

Section 5 provides that this act will take effect upon becoming a law, except as otherwise provided.

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:

The bill authorizes an assessment on workers' compensation policyholders in the voluntary market to fund deficits in the JUA, as explained in the Private Sector Impact, below.

The bill exempts the JUA from the premium tax and assessments for the Workers' Compensation Administration Trust and the Special Disability Trust Fund, as explained in the Government Sector Impact, below.

B. Private Sector Impact:***Subplan D Policyholders***

The one-time appropriation of \$25 million from the Workers' Compensation Administration Trust Fund (WCATF) in the Department of Financial Services (DFS) for transfer to the JUA will benefit current JUA policyholders currently subject to an assessment. It is anticipated that this appropriation, the JUA authority to request transfer from DFS of an amount not to exceed \$10 million from the WCAFT if a deficit is certified, tax and assessment exemptions provided to the JUA, and the annual administrative fee of \$475 provided under this bill will cover the estimated deficit in subplan D.

However, as premiums for Tiers One and Two are capped, workers' compensation policyholders in the voluntary market will continue to be subject to future assessments to cover any deficit as Tiers One and Two will not be actuarially sound until January 1, 2007. Each assessment on policyholders would be limited to 1-year period.

As of February 29, 2004, 32 percent of the policies bound in subplan D are minimum premium policies (811 of 2,534 policies). Currently, the maximum minimum premium policy in subplan D is \$938. The bill caps premiums for minimum premium policies at \$2,500 for Tiers One and Two until actuarially sound rates are adopted which will be no later than January 1, 2007. These policies are also subject to the \$475 administrative fee. These Tier One and Two minimum premium policies will be less expensive than the minimum premium policy currently available in subplan C (\$3,800 + \$475 administrative fee).

Workers' Compensation Policyholders in the Voluntary Market

The bill authorizes an assessment on workers' compensation policyholders in the voluntary market to fund deficits that might occur in Tier One, Tier Two, or attributable to subplan D after implementing the provisions of the bill. Workers' compensation policyholders in the voluntary market would be subject to an assessment for a period of 1 year following the effective date of an assessment. In 2002, approximately \$3 billion in workers' compensation premium was written in Florida. For example, an assessment of one percent could generate approximately \$30 million (1 percent of \$3 billion) that would be collected by insurers on new and renewal policies for the 1-year period.

Insurers and Self-Insured Employers

The one-time appropriation of \$25 million from the Workers' Compensation Administration Trust Fund in the Department of Financial Services for transfer to the JUA is not expected to result in an increase in the current assessment rate. (See also Government Sector, below)

C. Government Sector Impact:***Appropriation to Fund JUA Deficits***

The bill provides a one-time appropriation of \$25 million from the Workers' Compensation Administration Trust Fund (WCATF) in the Department of Financial

Services (DFS) for transfer to the JUA. The bill authorizes the JUA to request from the DFS transfer of an amount not to exceed \$10 million from the WCATF to fund any remaining deficits in Tiers One, Tier Two, or a deficit attributable to former subplan D subject to approval by the Legislative Budget Commission. The estimated June 30, 2004 unreserved fund balance is \$61.4 million before the transfer of this appropriation or transfer of an amount not to exceed \$10 million.

Additionally, this fund holds \$152 million in reserve for the contingent liability associated with litigation regarding the calculation of assessments for this trust fund and the Special Disability Trust Fund prior to July 1, 2001. The availability of these reserved funds is contingent upon the outcome of any appeal of the 1st District Court of Appeal opinion issued on March 16, 2004 relating to one of the insurers,¹¹ and any other outstanding litigation with insurers currently pending at the 1st District Court of Appeal.

JUA Annual Administration Fee

The bill requires employers to remit \$475 upon application for coverage and at renewal of coverage to cover costs for administration and fraud prevention. Under current law, subplans A, B, and C are subject to this fee. The JUA was unable to charge subplan D policyholders this fee due to the capped premiums for that subplan. As of February 29, 2004, there were 2,534 policyholders in subplan D. The \$475 application fee would have generated \$1.2 million in additional revenue to mitigate subplan D' deficit.

Impact of Exempting the JUA from the Premium Tax and Chapter 440 Assessments

The JUA estimates that it will pay only the premium tax filing fee of \$1,000 for 2004. The JUA estimates an exemption from Chapter 440 assessments will result in an annual savings of approximately \$6 million based on the estimated 2004 assessments.

Potential Tax Liability Due to Transferring Funds to the JUA

The JUA states it could receive a gift of up to \$26 million without incurring a tax liability in 2004. The tax liability attributable to a transfer in excess of this amount may constitute taxable income. This statement is based upon a cursory review of the JUA's potential tax position formulated using current projections and the assumption that no further revisions would be made.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

¹¹ Generally, both parties have 15 days to file motions for rehearing or an appeal of the 1st District Court of Appeal's decision. However, both parties in this case decided on March 16, 2004, agreed to allow an extension of 20 days to file any motions for rehearing.

VIII. Amendments:

None.

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