

# 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 2270

SPONSOR: Banking and Insurance Committee

SUBJECT: Workers' Compensation Joint Underwriting Association

DATE: April 2, 2004

REVISED: \_\_\_\_\_

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

## I. Summary:

Committee Substitute for Senate Bill 2270 provides a one-time appropriation and transfer of \$35 million from the Workers' Compensation Administration Trust Fund in the Department of Financial Services to the Workers' Compensation Joint Underwriting Association (JUA) for funding the estimated \$36 million deficit in subplan D for calendar year 2004 and provides the following changes relating to subplan D and the JUA:

- Requires the JUA to charge policyholders in subplan D an annual \$475 fee to cover costs of administration and fraud prevention.
- Prohibits the JUA from issuing a subplan D policy to an employer unless the employer has at least one non-exempt full-time employee in the governing class code (the employer's class code) and has payroll at least equal to the minimum hourly wage for one year at 40 hours per week. This effectively prohibits the JUA from issuing minimum premium policies, or zero payroll policies in subplan D. A minimum premium policy would still be available from subplan C at actuarially sound rates.
- Provides that a policyholder is no longer eligible for subplan D if during any 2-year period, it incurs two or more indemnity or medical claims and has incurred losses greater than \$5,000. If this claim trigger is reached at anytime during a 2-year period, the employer is immediately ineligible for subplan D. The employer remains ineligible for subplan D until it has 3 years of loss history with no indemnity and no medical claims exceeding 50 percent of premium.
- Maintains the current caps on subplan D surcharges over voluntary market premiums (25 percent for small employers and 10 percent for charitable organizations) for the first three years an employer is in subplan D. However, the surcharge is increased to 40 percent for the employer's 4<sup>th</sup> renewal, 60 percent for the 5<sup>th</sup> renewal, 80 percent for the sixth renewal, and 100 percent for the 7<sup>th</sup> and subsequent renewal.

- Provides that an employer may elect coverage in any subplan of the JUA for which the employer is eligible.
- Exempts the JUA from the premium tax and assessments for the Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund.
- Provides that in the event a deficit exists in Subplan D, after the implementation of the provisions of this bill, Subplan D policyholders would not be subject to assessment for an additional premium. Any deficit would be funded by an assessment, not to exceed 1 percent of premium, on all workers' compensation policies in the voluntary market for a period of 1 year.
- 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 1 member appointed by the Governor, 2 members appointed by the Senate President, and 2 members appointed by the Speaker. 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 as a non-profit entity for the benefit of its small employer policyholders. The state mutual fund would compete with private insurers. It is intended that the state appropriate adequate initial capitalization for the fund and that the fund be subject to the same financial and other requirements as apply to an authorized insurer.

Senate Bill 50-A was enacted in the 2003 Special Session A that created subplan D in the Workers' Compensation Joint Underwriting Association (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.<sup>1</sup> The bill also provided these policies are assessable, meaning that any deficit in the subplan must be funded by assessing the JUA policyholders for additional premiums.

Since these capped premiums are not actuarially sound, the JUA recently reported that subplan D incurred a \$9,864,901 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, as well as the history of largely unsuccessful attempts at collecting assessments from members of insolvent group self-insurance funds, the likelihood of collecting the total assessment is doubtful.

This bill substantially amends section 627.311 of the Florida Statutes.

## 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.<sup>2</sup> The changes provided in Senate Bill 50-A were designed to reduce costs, expedite the dispute resolution process, provide greater enforcement and

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<sup>1</sup> Senate Bill 50-A; ch. 2003-412, L.O.F.

compliance authority for the Division of Workers' Compensation to combat fraud, provide affordable coverage for small employers, revise certain indemnity benefits, and increase medical reimbursement fees for physicians and surgical procedures. Restrictions on exemptions in the construction industry, enacted by Senate Bill 50-A, were expected to increase the 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'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.

Prior to the passage of Senate Bill 50-A, premiums for coverage in the JUA were approximately three to four times the premiums charged in the voluntary market. The JUA indicated that their premiums should be 2.57 times higher than the voluntary market premium to remain actuarially sound, as compared to act's limits for subplan D of a 25 percent surcharge and a 10 percent surcharge for small employers and certain charitable organizations, respectively.<sup>3</sup> An employer with an experience 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.

Since subplan D policies are assessable, any deficits in the subplan will be assessed against the policyholders in that subplan. On February 27, 2004, the JUA notified the Office of Insurance Regulation (OFR) that subplan D incurred a deficit of \$9,864,901 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 OFR 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 OFR, the JUA may recognize a statutory deficit by the filing of any quarterly or annual financial report.<sup>4</sup> Each authorized insurer, including the JUA, is required to submit the annual statement and the audited financial report for the prior year to the OFR by March 1 and

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<sup>2</sup> JUA Subplan D Rate Filing to Implement Senate Bill 50-A, dated June 27, 2003.

<sup>3</sup> Memorandum from Kevin McCarty, Director of the Office of Insurance Regulation, dated February 11, 2004.

June 1, respectively.<sup>5</sup> 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 OFR 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 Department of Financial Services. 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 OFR 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*,<sup>6</sup> included legislative recommendations to alleviate and address the deficit in the JUA and to address long-term solvency issues. The staff report recommended that the Legislature should consider providing a one-time budget transfer from the Workers' Compensation Administration Trust Fund and exempting the JUA from the Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund assessments. To address long-term solvency issues and the overall viability of the subplan, the Legislature should consider 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 that are summarized below:<sup>7</sup>

*Funding the Existing Deficit.* If an assessment is to be avoided, measures must be adopted to fund 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.* There are several possible solutions to address the probability of the continuing growth of subplan D deficits. The Board feels constrained to note 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 FWCJUA to a more stable financial condition.

*Depopulation Incentives.* The depopulation of the JUA is unquestionably in the best interests of JUA policyholders. Providing additional encouragement and incentives to the voluntary market to take-out and keep-out residual market business seems to be the most effective way of doing that. 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

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<sup>4</sup> Section 624.424, F.S. (2003).

<sup>5</sup> Interim Project Report 2004-110, issued January 2004.

<sup>6</sup> Florida Workers' Compensation Joint Underwriting Association, Inc. *Statement of the Board of Governors Regarding 2004 Legislative Activities*, dated February 13, 2004.

this manner do not count against so-called “consent to rate” limitations contained in s. 627.171, F.S. The Board suggests consideration be given to expanding this incentive program.

The Board recommends expanding 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 were willing to continue doing business under that rating arrangement.

*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. Although rates in subplan D rates are lower than subplan C, the JUA believes, if given a choice, many employers would choose the higher, but actuarially sound rates of subplan C over the lower subplan D rates, which expose them to almost certain assessments. 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 (SDTF). Because the JUA is entitled to offset WCATF payments against its premium tax obligations, the JUA has not paid premium taxes. From 1994 through 2003, the JUA paid more than \$19 million in WCATF and SDTF assessments.

*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.* The Board recognizes that it cannot now predict the direction the Legislature may wish to take on matters relating to the JUA. The JUA could be asked to provide input on proposals that are not contemplated in this statement. For example, the Legislature might prefer a short-term approach to addressing the subplan D deficit. In that case, 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.<sup>8</sup> This includes funding the Division of Workers' Compensation in the Department of Financial Services, administering the payment of supplemental benefits payments for certain injured workers, and providing funding for ch. 440, F.S., programs administered by Office of the Judges of Compensation Claims, the Department of Education, the Agency for Health Care Administration, and the Department of Professional and Business Regulation.<sup>9</sup>

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.<sup>10</sup> The basis of the calendar-year assessment is the net premiums collected by carriers and the amount premiums calculated by the Department of Financial Services for self-insured employers. Presently, the assessment is 1.50 percent for calendar year 2003-04.

### **III. Effect of Proposed Changes:**

**Section 1** amends s. 627.311, F.S., relating to the Workers' Compensation Joint Underwriting Association, to revise eligibility requirements for subplan D and exempt the JUA from premium tax under s. 624.509, F.S., and assessments for the Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund under ss. 440.51 and 440.491, F.S., respectively. The section also provides the following changes:

#### *Annual Administrative Fee for Subplan D Policyholders*

Requires the JUA to charge policyholders in subplan D an annual \$475 fee to cover costs of administration and fraud prevention. Currently, this fee charged by JUA for all plans except Subplan D. The fee may be increased by the board, with the approval of OIR, pursuant to a rate filing to reflect increased costs of administration and fraud prevention.

#### *Elimination of Minimum Premium Policies in Subplan D*

Prohibits the JUA from issuing a subplan D policy to an employer unless the employer has at least one non-exempt full-time employee in the governing class code (the employer's class code) and has payroll at least equal to the minimum hourly wage for one year at 40 hours per week. This effectively prohibits the JUA from issuing minimum premium policies, or zero payroll policies in subplan D. A minimum premium policy would still be available from subplan C at actuarially sound rates.

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<sup>7</sup> Section 440.50, F.S. (2003).

<sup>8</sup> 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.

<sup>9</sup> Section 440.51, F.S. (2003).

*Ineligibility for Subplan D if Certain Claims Incurred*

Provides that a policyholder is no longer eligible for subplan D if during any 2-year period, it incurs two or more indemnity or medical claims and incurred losses greater than \$5,000. If this claim trigger is reached, the employer is immediately ineligible for subplan D. The employer remains ineligible for subplan D until it has 3 years of loss history with no indemnity and no medical claims exceeding 50 percent of premium. The policyholder could be placed in another subplan if the policyholder meets the eligibility criteria for such subplan.

*Rates in Subplan D*

Maintains the current caps on subplan D surcharges over voluntary market premium (25% for small employers and 10 percent for charitable organizations) for the first three years an employer is in subplan D. However, the surcharge is increased to 40 percent for the employer's 4<sup>th</sup> renewal, 60 percent for the 5<sup>th</sup> renewal, 80 percent for the sixth renewal, and 100 percent for the 7<sup>th</sup> and subsequent renewal.

*Policyholder Choice of Subplans*

Provides that an employer may elect coverage in any subplan of the JUA for which the employer is eligible.

*Assessments to Fund Deficits in Subplan D*

Provides that in the event a deficit occurs in Subplan D, after the implementation of the provisions of this bill, Subplan D policyholders would not be subject to assessment for an additional premium. Any deficit would be funded through an assessment, not to exceed 1 percent of workers' compensation premium written in Florida. The assessment would be levied on all new and renewed workers' compensation policies in the voluntary market 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.

*Prohibition on Affiliated Persons Receiving Coverage in the Voluntary Market*

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. The current law could be circumvented by obtaining coverage through a spouse or another business entity which would be prohibited under this provision.

*Workers' Compensation Insurance Market Evaluation Committee*

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 1 member appointed by the Governor, 2 members appointed by the Senate President, and 2 members appointed by the Speaker. The committee must meet monthly and report quarterly on the status of the workers' compensation market. 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 as a non-profit entity for the benefit of its small employer policyholders. The state mutual fund would compete with private carriers and would be charged with the public mission of customer service, quality loss prevention, timely claims management, active fighting of fraud, and compassionate care for injured workers, at the lowest cost consistent with actuarial sound rates. It is further intended that state appropriate adequate initial capitalization for the fund and that the fund be subject to the same financial and other requirements as apply to an authorized insurer.

**Section 2** provides a one-time transfer of \$35 million from the Workers' Compensation Administration Trust Fund in the Department of Financial Services to the Workers' Compensation Joint Underwriting Association to provide funding for the deficit in subplan D no later than July 31, 2004.

**Section 3** provides that this act will take 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:

*Subplan D Policyholders*

The \$35 million transfer to the JUA would benefit current JUA policyholders that are subject to an assessment since this transfer, coupled with the JUA's taxation and assessment exemptions, would cover the estimated deficit in subplan D. However, if the premiums remain capped at their current levels, workers' compensation policyholders in



the voluntary market would continue to be subject to future assessments to cover any deficit since the subplan would not be actuarially sound. Such assessments on policyholders would be limited to one percent per year of total workers' compensation premiums written.

As of February 29, 2004, 811 (32%) of the 2,534 policies that have been bound in subplan D are minimum premium policies. Further, a preliminary review of the current subplan D rates, minimum premiums and surcharges suggests that an imputed wage of \$10,712 in the governing classification, as provided in the bill, would eliminate all minimum premium policies from subplan D. It should be noted, however, that while the subplan D premium associated with the imputed wage for some employers will be greater than the subplan D minimum premium for the governing classification, these premiums will still be less than the minimum premiums in subplans A, B and C.

*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 subplan D. Workers' compensation policyholders in the voluntary market would be subject to an assessment that could not exceed 1 percent of workers' compensation premiums written in Florida for a period of 1 year following the effective date of the assessment. In 2002, approximately \$3 billion in workers' compensation premium was written in Florida. Such an assessment would be limited to approximately \$30 million (1 percent of \$3 billion) and would be collected by insurers on new and renewal policies for the 1 year period.

*Insurers and Self-Insured Employers*

The \$35 million transfer from the Workers' Compensation Administration Trust Fund to the JUA is not expected to result in an increase in the current assessment rate of 1.50 percent for self-insured employers and insurers for fiscal year 2004-05. (See also Government Sector, below)

C. Government Sector Impact:

*Impact of \$35 Million Transfer to the JUA*

The JUA states, that based on a cursory review of the JUA's potential tax position in 2004 based upon current projections and assuming no further revisions, the JUA estimates that it could receive a gift of up to \$26 million without incurring a significant tax liability.

*JUA Application Fees for Subplan D*

It is estimated that 4,466 Subplan D policies will be written during the period of July 1, 2004 through December 31, 2004. Accordingly, \$2,121,350 of additional premium is expected to be generated as a result of this administrative fee of \$475 per policy that is mandated in the bill.

*Impact of Exempting the JUA from the Premium Tax and Chapter 440 Assessments*<sup>11</sup>

It is currently estimated that the JUA will pay only the premium tax filing fee of \$1,000 for 2004. Contingent upon the effective date of the bill, approximately \$3-4 million in assessments could be avoided in 2004. The JUA provided the following information regarding the impact exempting the JUA from the assessments on a calendar year basis:

2004	All Subplans	Subplan D Only
1st Quarter	\$ 1,032,993	\$ 472,136
2nd Quarter	1,173,967	536,861
3rd Quarter	1,328,988	608,956
4th Quarter	<u>1,491,076</u>	<u>683,962</u>
2004 Totals	\$ 5,027,024	\$2,301,915

*Workers' Compensation Administration Trust Fund- Impact of the \$35 Million Transfer*  
 According to the Division, the expected Workers' Compensation Administration Trust Fund investment account reserve balance at the end of FY 2003-04 is projected to be \$62 million. For FY 2003-04, the Division provided a contingent liability or funding for \$152 million in refund requests associated with litigation regarding the calculation of assessments for this trust fund and the Special Disability Trust Fund prior to July 1, 2001. (See below for a summary of the litigation.) The projected balance at the end of FY 2004-05 is expected to be \$59 million which would be reduced to \$24 million if \$35 million is transferred to the JUA, as provided in this bill. The available balance in the Workers' Compensation Administration Trust Fund is contingent upon the outcome of any appeal of the 1st DCA opinion issued on March 16, 2004.

On July 25, 2002, the trial court found that Riscorp and the Florida Hospitality Mutual Insurance Company were entitled to refunds or credits against their assessment obligations for overpayments of assessments. The Department of Financial Services sought review of the trial court's final judgments declaring that Riscorp and Florida Hospitality Mutual Insurance Company were entitled to refunds for their overpayments for assessments. On March 16, 2004, the 1st District Court of Appeal reversed the trial court's final judgments to the extent that appellees' (insurers) refunds are attributable to reinsurance premiums. The court affirmed the final judgments to the extent that insurers' refunds are attributable to brokerage fees and commissions. This opinion is not final until the 15-day period expires for filing a motion for rehearing and the disposition thereof, if filed.

**VI. Technical Deficiencies:**

None.

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<sup>10</sup> Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund assessments, ss. 440.51 and 440.49, F.S., respectively.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.

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

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