

# 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 2442

SPONSOR: Banking and Insurance Committee and Senator Margolis

SUBJECT: Life Insurance and Annuity Contracts; Charitable Organizations

DATE: April 15, 2004      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Emrich</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Fav/CS</u>
2.	_____	_____	<u>FT</u>	_____
3.	_____	_____	<u>AGG</u>	_____
4.	_____	_____	<u>AP</u>	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

Insurance companies transacting insurance in Florida are required to obtain a certificate of authority (COA) issued by the Office of Insurance Regulation (OIR). However, there are exceptions to the requirement to obtain a COA which apply to insurers with respect to certain transactions. Committee Substitute for Senate Bill 2442 would add another exception to the certificate of authority requirement, by allowing an insurer domiciled outside of the United States to operate from offices within Florida for transactions involving life insurance policies and annuity contracts sold to non-residents of the United States, provided the insurer meets specified financial and disclosure requirements. The bill makes the following changes:

- requires such insurers to be authorized insurers in their country of domicile for the prior 3 years, or a wholly owned subsidiary thereof, and to have offered the types of insurance it proposes to offer in Florida;
- allows the OIR to waive the above 3-year requirement if the insurer has operated successfully for a period of 1 year and has capital and surplus of at least \$25 million;
- provides the OIR with annual and quarterly financial statements in the English language; maintain a surplus as to policyholders of at least \$15 million; have a good reputation as to providing service to insureds; agree to make books and records available to the OIR; provide disclosures in the application and contract that the policy is governed by the laws of a foreign country and, if the insurer becomes insolvent, disclose that the policy is not covered by the Florida Life and Health Guaranty Association;
- provides that the insurer is not exempt from the agent licensure requirements under the Insurance Code; provide that the insurer is subject to the Unfair Trade Practices provisions under ch. 626, F.S., and that the policies written under this provision are exempt from the Florida premium tax requirements; and

- requires the provisions of the Florida Money Laundering Act (ch. 896, F.S.) to apply to all single premium life insurance policies and annuity contracts issued to persons who are not residents of the United States.

The bill also broadens the definition of the term “charitable organization.” Under current law, such organizations may purchase life insurance on an insured who consents to the ownership or purchase of that insurance. Under the expanded definition, charitable organizations would include specified tax exempt organizations that could approve for-profit entities to obtain life insurance policies or annuity contracts on the life of individual insureds. Before an entity could qualify as a charitable organization, the insured would have to be an accredited investor or the approving organizations must have total assets in excess of \$5 million. The bill would prohibit the assignment or transfer of the life insurance policy with certain exceptions, e.g., in cases of material default, insolvency of either the life insurer or annuity company, or misrepresentation.

This bill substantially amends sections 624.402 and 627.404 of the Florida Statutes.

## II. Present Situation:

### Background - Certificates of Authority to Transact Insurance

Insurance companies transacting insurance in Florida are required to obtain a certificate of authority (COA) issued by the Office of Insurance Regulation (OIR).<sup>1</sup> These insurers are known as authorized insurers.<sup>2</sup> To qualify for a COA, a prospective insurer<sup>3</sup> must meet specified financial criteria including maintaining reserves<sup>4</sup> applicable to the kind of insurance transacted by the insurer, as well as maintaining specified assets, deposits, capital, and surplus. Insurers must provide the OIR with specified background information and meet trustworthiness, fitness, and criminal history requirements. According to OIR staff, it takes about 90 days for a company to obtain a COA and the fee is \$1,500.

There are several exceptions to the requirement to obtain a COA which apply to insurers with respect to specified transactions ranging from surplus lines coverages and reinsurance to captive insurers.<sup>5</sup>

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<sup>1</sup> Section 624.401, F.S.

<sup>2</sup> Section 624.09, F.S. An unauthorized insurer does not have a certificate of authority issued by the OIR.

<sup>3</sup> Insurers are divided into three categories under the Insurance Code: domestic insurers are formed under the laws of Florida; foreign insurers are formed under the laws of any state, district, or territory or commonwealth of the United States, other than Florida; and alien insurers are defined as insurers other than domestic or foreign insurers. Foreign and alien insurers must also meet certain capital, surplus, and operational requirements.

<sup>4</sup> Part I of ch. 625, F.S.

<sup>5</sup> These exemptions pertain to transactions involving surplus lines coverages; specified reinsurance; captive insurance companies; investments by foreign insurers; servicing life or health insurance policies or annuity contracts pertaining to insurers that have withdrawn from Florida; policies covering only subjects of insurance not resident or expressly performed in this state at the time of issuance and lawfully solicited or delivered outside this state; and, investigation or litigation of specified claims under policies written in this state, or liquidation of assets and liabilities of the insurer, all as resulting from its former authorized operations in Florida. Captive insurers are created and owned by one or more non-insurers, for the primary purpose of providing their owners with coverage, usually at rates lower than those of other insurers.

Insurance companies domiciled outside of the United States that do not possess a COA are referred to non-authorized alien insurers. The insurance products offered by these alien insurers may not be sold from offices in Florida, even to non-U.S. residents, without the company obtaining a COA. Currently, there are two alien insurers who are licensed in Florida (have certificates of authority), are domiciled outside of the U.S., and market to non-U.S. residents from offices in Florida.<sup>6</sup>

According to proponents of the bill, obtaining a certificate of authority by alien insurers that want to market products in Florida to non-U.S. residents is both a time-consuming and expensive process.<sup>7</sup> These proponents state that by allowing alien insurers to establish offices in this state to serve non-U.S. residents would be an economic boon to the economy of South Florida. They point to a recent study by the Beacon Council (a public-private economic development consortium in Dade county) which estimates that annual premium income from sales of insurance products to Latin Americans is in the billions of dollars and that, if such products could be sold and serviced from Florida, Florida's economy would experience a substantial economic benefit.

These proponents state that the advantages of marketing such insurance products to non-U.S. residents, compared with the same products issued by authorized Florida insurers, and the costs and restrictions imposed on Florida insurers, prevents Florida from participating in this "offshore" insurance market. Further, the proposed legislation contains numerous prudential safeguards which will afford the OIR the opportunity to regulate those selling these life insurance and annuity products.<sup>8</sup>

### **Surplus lines Requirements**

The Florida Insurance Code contains specific financial and other requirements that unauthorized insurers must comply with in order to become eligible surplus lines insurers<sup>9</sup>. Generally, surplus lines insurance is insurance coverage provided by a company that is not licensed in Florida, but that is allowed to do business in the state, as an "eligible" insurer, because the particular coverage offered is not available from insurers authorized to sell insurance in Florida.

The law establishes requirements for approval of eligible surplus lines insurers and licensure of surplus lines agents by the OIR, including the provision that the surplus lines insurer maintain a surplus as to policyholders of \$15 million, have been licensed in its state or country of domicile for a least three years, and furnish annual and quarterly financial statements to the OIR.<sup>10</sup> The law also specifies the conditions that must be met before insurance coverage may be exported to an eligible surplus lines insurer, also referred to as a nonadmitted insurer. Surplus lines insurance

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<sup>6</sup> International Health Insurance Danmark (IHID)A/S, Copenhagen, Denmark, market's accident and health insurance policies; and Citicorp International Insurance Company, Ltd., in Bermuda, offers annuity products.

<sup>7</sup> According to representatives with the OIR, it took about nine months to 2 years to license Citicorp and IHID, respectively, because of the difficulty of completing criminal and other background screenings on the non-resident officers, directors, and owners. Any large expense is attributable to costs associated with lawyers hired to represent the company throughout the COA process.

<sup>8</sup> Life insurance policies and annuity contracts are regulated under part III of ch. 627, F.S.

<sup>9</sup> Section 626.918, F.S.

<sup>10</sup> Section 626.918, F.S.

is not subject to Florida regulation of rates or forms and there is no insurance guaranty fund protection if the insurer becomes insolvent.

### **Unfair Trade Practices**

Insurance companies are prohibited from engaging in specified unfair methods of competition and unfair or deceptive acts and practices under s. 626.9541, F.S. Twenty seven unfair acts are specified ranging from misrepresentations and false advertising of insurance policies and unfair discrimination to defamation and intimidation. Insurers engaging in such acts may be fined, depending on whether the act is nonwillful or willful, or otherwise sanctioned by the OIR.

### **Premium Tax**

Under current law, each insurer must annually on or before March 1, pay to the Department of Revenue a tax on insurance premiums, premiums on title insurance, assessments, and on annuity premiums.<sup>11</sup> These taxes are in an amount of 1.75 percent of the gross amount of specified policies and contracts.<sup>12</sup> Further, insurers are allowed to take specified credits and deductions against the premium tax.

### **Charitable Organizations**

Under s. 627.404(2), F.S., a charitable organization that meets the requirements of a not-for-profit organization under s. 501 (c)(3) of the Internal Revenue Code may own or purchase life insurance on an insured who consents to the ownership or purchase of that insurance.<sup>13</sup> The charitable organization would therefore own what is termed an “insurable interest” in the insured, e.g., a lawful and substantial economic interest in the subject of the insurance.

There are currently no provisions in Florida law to allow a not-for-profit organization<sup>14</sup> to approve a separate and independent for-profit entity, e.g., trust, partnership, or limited liability company, to obtain or procure life insurance policies and annuity contracts on the life of an individual insured.

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

**Section 1.** Amends s. 624.402, F.S., pertaining to COA exceptions, to insert a new subsection (8). The bill provides that transactions involving life insurance policies or annuity contracts issued by an insurer domiciled outside the United States covering only persons who are not U.S. residents at the time of issuance, are exempt from the requirement to obtain a certificate of authority, provided the insurer meets specified financial and disclosure requirements. These requirements are similar to the provisions in current law that unauthorized insurers must meet to

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<sup>11</sup> Section 624.509, F.S. There are exceptions to the payment of such taxes for wet marine and transportation insurance under s. 624.510, F.S.

<sup>12</sup> The provision also provides that an amount equal to 1 percent of gross receipts is to be paid on annuity policies or contracts.

<sup>13</sup> Under s. 627.404(1), F.S., an insurer is entitled to rely upon the statements made by an applicant for insurance relative to the insurable interest which such applicant has in the insured.

<sup>14</sup> Or organizations to which charitable contributions could be made under ss. 170 (c)(1) - (3) of the Internal Revenue Code of 1986, as amended. Organizations described in 170 (c) include various public and charitable entities.

become eligible surplus lines insurers under s. 626.918, F.S. (*See*, discussion above under Present Situation.) The insurer must comply with the following requirements:

- be an authorized insurer in its country of domicile as to the kinds of insurance proposed to be offered and must have been an insurer for not less than the 3 years next preceding, or a wholly owned subsidiary of an authorized insurer or, must be the wholly owned subsidiary of an already eligible authorized insurer as to the kind or kinds of insurance proposed for not less than the 3 years next preceding. However, the OIR may waive the 3-year requirement if the insurer has operated successfully for a period of 1 year and has capital and surplus of at least \$25 million.
- furnish the OIR with its current annual financial statement in English language, and with such additional information the OIR requests.
- maintain a surplus to policyholders of at least \$15 million and such surplus must be represented by investments consisting of eligible investments for like funds of like domestic insurers under part II of ch. 625;<sup>15</sup> however, any such surplus as to policyholders may be represented by investments permitted by the domestic regulator of such alien insurance company if such investments are substantially similar in terms of quality, liquidity, and security to eligible investments for like funds of like domestic insurers under part II of ch. 625.
- have a “good reputation” as to providing services to policyholders and paying losses and claims.
- furnish the OIR with authenticated copies of its current and quarterly financial statements in the English language.
- agree to make its books and records available for OIR inspection.
- provide the applicant a copy of its most recent quarterly financial statement as well as the date of organization of the insurer; the identity of and rating assigned by each rating organization or, if applicable, that the insurer is unrated; that the insurer does not hold a certificate of authority issued in Florida and that the OIR does not exercise regulatory oversight over the insurer; and the identity and address of the regulatory authority exercising oversight of the insurer.

The bill further provides that the OIR has no responsibility to determine the actual financial condition of the insurer and that if the OIR has reason to believe that the insurer is insolvent or in unsound financial condition, it shall withdraw the insurer’s eligibility to issue policies or contracts. The legislation provides that the insurer is not exempt from agent licensure requirements of ch. 626, F.S., and must appoint agents used to sell such policies or contracts as provided by that chapter. The insurer is also subject to the Unfair Trade Practices provisions under part IX of ch. 626, F.S. The measure provides that policies written under this section are exempt from the premium tax specified in s. 624.509, F.S.

Applications for life insurance coverage must contain in 12-point type a statement to the effect that the policy is governed by the laws of a foreign country and, if the insurer becomes insolvent, the policy is not covered by the Florida Life and Health Guaranty Association. All life insurance policies and annuity contracts must contain a disclosure on the first page of the policy or contract in 10-point type, that the benefits of the policy are governed primarily by the law of a country other than the United States. Finally, it applies the Florida Money Laundering Act

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<sup>15</sup> Part II of ch. 625, F.S., provides for investment requirements for domestic insurers and commercially domiciled insurers.

(ch. 896, F.S.) to all single premium life insurance policies and annuity contracts issued to persons who are not residents of the United States.

**Section 2.** Amends s. 627.404, F.S., relating to insurable interests, to broaden the definition of the term “charitable organization” for purposes of allowing charitable organizations to own or purchase life insurance on an insured who consents to the ownership or purchase of that insurance, to include:

1. any organization that meets the requirements of s. 501 (c)(3) of the IRS code;
2. any organization to which charitable contributions could be made under s. 170 (c)(1), (c)(2), or (c)(3) of the IRS code; or
3. any trust, partnership, limited liability company, or similar entity that is approved in writing by an organization described in 1. or 2. above to procure the combination of life insurance policies or annuity contracts on the life of an individual insured. Before an entity described in this provision can qualify as a “charitable organization” for the purposes of this provision, either: a) the individual insured must be an “accredited investor” as defined in s. 230.501(a) in Rule 501 Reg D of the Securities Act Rules; or b) the approving organization described above in 1. or 2. must have total assets in excess of \$5 million at the time of application for the life insurance policy and annuity contract is made.

The bill prohibits the assignment or transfer of the life insurance policy procured by a trust, partnership, limited liability company, or similar entity, with certain exceptions, e.g., in cases of material default, insolvency of either the life insurer or annuity company, or misrepresentation of the individual insured on the application for either the life insurance policy or annuity contract providing grounds for a contest by the life insurer or annuity company. Further, the charitable organization has an insurable interest in the life of the insured whether the organization originally purchased the insurance or the insurance is later transferred to the charitable organization by the insured.

According to representatives with the OIR, the provisions in this section of the bill would allow charities to approve for-profit entities to obtain life insurance policies and annuity contracts which would have unintended consequences potentially harmful to consumers. For example, under this proposal, an unlicensed viatical provider<sup>16</sup> could persuade a charity to allow it to obtain life insurance policies and annuity contracts on individuals without being subject to any regulation by the office. Currently viatical transactions are regulated by the OIR and the Department of Financial Services under part X of ch. 626, F.S. Further, a fraudulent unlicensed viatical settlement provider could operate as a state sanctioned “charitable organization” so long as it met the provisions of the bill. Officials with the OIR also state that there are no provisions in the bill that authorize the charitable organization to receive the death benefits of the life insurance policies because the for-profit entity owns and controls the subject policies.

**Section 3.** Provides that, except for this section and section 2, which shall take effect upon becoming a law, this act shall take effect July 1, 2004.

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<sup>16</sup> A viatical settlement provider is an entity which purchases the life insurance policy and beneficiary rights from the viator. Providers must be licensed by the Office of Insurance Regulation. A viator is the owner of a life insurance policy who enters into a viatical settlement agreement by selling the policy ownership and beneficiary rights in exchange for a cash payment.

**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:**

Life insurance policies and annuity contracts sold to non-U.S. residents by an unauthorized alien insurer meeting the criteria of this bill would be exempt from the premium tax. No estimate of the fiscal impact has been determined.

**B. Private Sector Impact:**

The provisions of the bill (section 1 of the bill) would benefit alien insurance companies because such entities could establish offices in Florida to serve non-U.S. residents, without having to obtain a certificate of authority. Authorized insurers currently serving non-U.S. residents may find increased competition for sales.

Proponents of this legislation state that most variable annuity and life insurance products sold in the international market now contain imbedded investment elements. Often these products are customized. Non-U.S. residents generally will be subject to U.S. withholding tax with respect to returns related to the investment elements of these products. The same variable annuity and life insurance products issued by alien or offshore insurers are not subject to the U.S. withholding tax. Consequently, products issued by U.S. insurers are not generally tax efficient for non-resident purchasers.

These proponents also assert that the bill will benefit the economy of South Florida. A recent study by the Beacon Council estimates that annual premium income from sales of insurance products to Latin Americans is in the billions of dollars and that, if such products could be sold and serviced from Florida, Florida's economy would experience substantial economic benefit in terms of jobs created and other benefits.

The bill appears to expand the fundraising ability of not-for-profit entities to facilitate charitable gifts through the coordinated use of life insurance policies and annuity contracts (section 2 of the bill). According to proponents of the charitable organization provisions, the current low cost fixed-yield capital markets serve as the funding

mechanism that allow donors to effectively make substantial monetary gifts to favored charities upon their (donors') death.

**C. Government Sector Impact:**

According to representatives with the Office of Insurance Regulation, the additional reviews and monitoring responsibilities provided for under section 1 of the bill can be absorbed within existing resources.

**VI. Technical Deficiencies:**

None.

**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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