HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1091 Insurer Insolvency
SPONSOR(S): Ambler and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 2130

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Insurance Committee	14 Y, 0 N	Tinney	Cooper
2) Local Government Council	6 Y, 0 N	Camechis	Hamby
3) State Administration Appropriations Committee	6 Y, 0 N	Rayman	Belcher
4) Commerce Council			
5)			

SUMMARY ANALYSIS

When an insurer faces financial difficulties or insolvency, the Division of Rehabilitation and Liquidation of the Department of Financial Services (DFS) intervenes to protect the affected insurer's policyholders. The bill amends the law to eliminate the need for an affected policyholder to file a "proof of claim" form before receiving a refund of unearned premium or a claim settlement from the Florida Insurance Guaranty Association (FIGA). Instead, the Department of Financial Services (DFS) is authorized to certify and remit policyholder information for refunds or claims directly to FIGA

In addition to the consumer protections afforded by the Division of Rehabilitation and Liquidation, Florida operates several insurance guaranty funds to ensure that policyholders are protected with respect to insurance premiums paid and settlement of outstanding claims, up to limits provided by law. The Florida Insurance Guaranty Association (FIGA) is responsible for many lines of insurance, including residential and commercial property, automobile insurance, and liability insurance, among others.

Funds available to FIGA are the result of an annual assessment of up to 2 percent of each specified insurer's net direct written premiums for the previous year. In 2005, a 2 percent assessment on each insurer's 2004 net direct written premiums would have yielded approximately $200 million had the maximum amount been assessed, however, there was no assessment to FIGA members either in 2003, 2004, or 2005.

On August 24, 1992, Hurricane Andrew devastated much of Dade County. By December 1992, six insurers were declared insolvent due to their inability to settle claims received following Hurricane Andrew. The Legislature met in special session in December 1992 to consider remedies for affected homeowners whose insurers were unable to pay valid claims.

Chapter 92-345, Laws of Florida (LOF) resulted from the December 1992 special legislative session. Under the law, the city of Homestead was authorized to issue municipal revenue bonds to fund FIGA obligations resulting from the multiple insolvencies that resulted from Hurricane Andrew claims. The revenue bonds issued by the city of Homestead did not pledge any assets or taxing authority of Homestead. Rather, the Legislature authorized FIGA to charge its members a special 2 percent assessment in addition to the regular assessment of up to 2 percent. The additional assessment served as the revenue stream pledged to retire the bonds issued by Homestead.

Under the bill, FIGA is authorized to contract with a city or county, or a combination thereof to issue tax-exempt revenue bonds for hurricane recovery. The provisions of the bill closely follow the law enacted by the 1992 Legislature to enable FIGA to pay the hurricane-related claims of insurers who became insolvent following Hurricane Andrew. As in 1993, FIGA will guarantee the tax-exempt bonds through the imposition of an emergency assessment of up to 2 percent in addition to the regular FIGA assessment. The guaranty association is authorized to charge the emergency assessment for the life of the bonds.

There does not appear to be an immediate fiscal impact to the state from the provisions in the bill.

Provides that the bill shall take effect upon becoming a law.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Empower Families and Maintain Public Security—The bill ensures that FIGA will have funds sufficient to settle the claims and refund unearned premium to a policyholder whose insurer becomes insolvent following hurricane damage in the state. Following the damage caused by the hurricanes that struck Florida in 2004 and 2005, it has become clear that Florida citizens and their communities are well-served by quick and efficient claim settlement by insurers.

B. EFFECT OF PROPOSED CHANGES:

Background

In Florida, regulation of the insurance industry is shared by the Department of Financial Services (DFS) and the Office of Insurance Regulation (OIR). The state's Chief Financial Officer (CFO) heads DFS while the head of OIR is the Governor and Cabinet members sitting as the Financial Services Commission. Generally, OIR is responsible for granting a certificate of authority or license to an insurer. A domestic insurer, i.e., an insurer based in Florida, must possess a certificate of authority in order to conduct business in Florida. The regulation and licensure of insurance agents and agencies is the purview of DFS. Staff of DFS also provides consumer information and assistance through the Division of Consumer Services. When an insurer faces financial difficulties or insolvency, the Division of Rehabilitation and Liquidation of DFS intervenes to protect the affected insurer's policyholders.

Chapter 631, F.S., relates to insurer insolvency and guaranty payments and governs the receivership process for insurance companies in Florida. Federal law specifies that insurance companies cannot file for bankruptcy. Instead, they are either "rehabilitated" or "liquidated" by the Division of Rehabilitation and Liquidation (the Division) of DFS.

By law, a delinquency proceeding is initiated by the Division against any insurer believed to be insolvent or experiencing an impairment of its capital reserves or surplus. A delinquency proceeding may include liquidation, rehabilitation, reorganization, or conservancy. Staff of the Division indicates that rehabilitation and liquidation are the two most common delinquency proceedings. By law, the Division of Rehabilitation and Liquidation files all delinquency proceedings in the Circuit Court in Leon County.

Insurance Guaranty Funds: General Information

In addition to the consumer protections afforded by the Division of Rehabilitation and Liquidation, Florida operates several insurance guaranty funds to ensure that policyholders are protected with respect to insurance premiums paid and settlement of outstanding claims, up to limits provided by law. A guaranty association generally is a not-for-profit corporation created by law directed to protect policyholders from financial losses and delays in claim payment and settlement due to the insolvency of an insurance carrier. A guaranty association accomplishes its mission by assuming responsibility for settling claims and refunding unearned premiums to policyholders. The term "unearned premium" refers to that portion of a premium that is paid in advance, typically for 6 months or 1 year, and which is still owed on the unexpired portion of the policy.

Florida's guaranty associations are comprised of insurer representatives. Insurers are required by law to participate in guaranty associations as a condition for transacting business in the state. Monies available through a guaranty association for claims settlement and premium refunds are paid by insurers as a percentage of their total collected premiums. The percentage of premiums payable to a

guaranty association is determined by law, although nationally it typically ranges from 1-3 percent. In many cases, a guaranty association also is authorized by law to assess an additional amount if an emergency arises and the association lacks sufficient funds to pay outstanding claims and to refund unearned premiums. This means, in essence, that insurers licensed to transact insurance in a state assess or tax their respective premium income streams to pay the outstanding claims and unearned premiums of an insolvent insurer.

Most states, including Florida, have more than one insurance guaranty association. Each association is assigned by law to pay outstanding claims and unearned premium, up to limits specified by law, for specific lines of insurance. In Florida, there are four guaranty associations created in chapter 631, F.S. The Florida Life and Health Insurance Guaranty Association generally is responsible for claims settlement and premium refunds for health and life insurers who are insolvent. The Florida Health Maintenance Organization Consumer Assistance Plan offers assistance to members of an insolvent HMO and the Florida Workers' Compensation Insurance Guaranty Association is directed by law to protect policyholders of workers' compensation insurance. The fourth guaranty association is the Florida Insurance Guaranty Association (FIGA). It is responsible for most remaining lines of insurance, including residential and commercial property, automobile insurance, and liability insurance, among others.

The Florida Insurance Guaranty Association (FIGA)

Provisions relating to FIGA, which was created in 1970, are contained in part II of chapter 631, F.S. The board of directors for FIGA is directed by law to be comprised of at least five, and no more than nine members; members serve on the FIGA board for a 4-year term. According to the FIGA website www.figafacts.com, the current FIGA board includes eight members, including one representative each of Nationwide, Allstate, State Farm, and The Hartford, among others.

The law directs FIGA to pay any eligible claim of more than $100 and less than $300,000, less any applicable deductible, with a few specified exceptions (s. 631.57, F.S.) Funds available to FIGA are the result of an annual assessment of up to 2 percent of each specified insurer's net direct written premiums for the previous year. In 2004, a 2 percent assessment on each insurer's 2003 net direct written premiums would have yielded approximately $188 million had the maximum amount been assessed; however, there was no assessment to FIGA members either in 2003 or 2004. Other monies that accrue to FIGA include receivership payments from DFS and from the agencies that liquidate the estates of insolvent insurers in other states.

The law creates three accounts under FIGA:

- auto liability account;
- auto physical damage account; and
- an account for all other included insurance lines (the all-other account).

The last FIGA assessments occurred in 2002. According to documents provided by FIGA, in December 2002, member insurers writing policies covered by the auto liability account were assessed 1.125 percent of their net direct premiums collected in 2001. Similarly, FIGA made an assessment for the auto physical damage account in 2002, as well, although that assessment was for .75 percent. There was no assessment in 2002 for the all-other account. According to FIGA, it has assessed the maximum of 2 percent only once in the past 11 years. The maximum assessment was levied in 1993, only for the all-other account, after more than six insurers were declared insolvent in the first several months following Hurricane Andrew. The law, at s. 631.56(2)(d), F.S., prohibits the use of any state funds by FIGA to settle claims and return unearned premiums.

The law authorizes insurers to include the cost of their annual FIGA assessment in their rate schedule. This means an insurer may recoup its assessment through increasing its policy rates, subject to OIR

approval. Generally, however, a guaranty association assessment is one of many factors an insurer considers in setting its rates.

Changes Proposed by the Bill: Guaranty Associations

Under current law in s. 631.181, F.S., a policyholder whose insurer becomes insolvent must file a “proof of claim” form with the Division of Rehabilitation and Liquidation before refund of unearned premiums may be returned to the policyholder or before an outstanding claim may be settled. According to the division, the records and files of many insolvent insurers are complete and the division is able to determine what amounts are owed to policyholders. In many cases, policyholder information may be complete in electronic format; this means the division could certify the names and amounts due to policyholders by electronic data transfer, if such certification were permissible by law.

The bill will allow the Division of Rehabilitation and Liquidation to certify to FIGA, based upon complete records of the insurer, the names of policyholders and the amount of unearned premium due to each. The division and FIGA may determine the best format for transfer of information relating to an insolvent insurer.

Background

Local Government Revenue Bonds

Article VII of the Florida Constitution governs finance and taxation by the state and its political subdivisions. In that article, the state and its political subdivisions, including municipalities and counties, are authorized to issue bonds. In most cases, bonds issued either by a city or a county are tax exempt. The tax-exempt status generally makes bonds issued by governmental entities an attractive investment instrument.

FIGA as Bond Guarantor after Hurricane Andrew

On August 24, 1992, Hurricane Andrew devastated much of Dade County. By December 1992, six insurers were declared insolvent due to their inability to settle claims received following Hurricane Andrew. The Legislature met in special session in December 1992 to consider remedies for affected homeowners whose insurers were unable to pay valid claims.

Chapter 92-345, Laws of Florida (LOF) resulted from the December 1992 special legislative session. Under the law, the city of Homestead was authorized to issue municipal revenue bonds to fund FIGA obligations resulting from the multiple insolvencies that resulted from Hurricane Andrew claims. The revenue bonds issued by the city of Homestead did not pledge any assets or taxing authority of Homestead. Rather, the Legislature authorized FIGA to charge its members a special 2 percent assessment in addition to the regular assessment of up to 2 percent. The additional assessment served as the revenue stream pledged to retire the bonds issued by Homestead. Beginning in 1993, FIGA members were assessed the full 2 percent regular assessment. That same year, and for the following 3 years—through 1996—the full 2 percent special assessment also was collected from FIGA members. Only in 1993 did FIGA impose both 2 percent assessments. By 2000, FIGA had sufficient funds to defease (i.e. “pay off”) the Homestead bonds, although those funds were reserved to make the regular annual payments until the bonds expired in 2003.

The 2004 and 2005 Florida Hurricane Seasons

The 2004 hurricane season was particularly destructive for Florida, with four hurricanes causing extensive damage throughout the state. All four hurricanes occurred within a 45-day period beginning August 13. 2004, when Hurricane Charley made landfall as a category 4 hurricane with wind speeds of 145 miles per hour; followed on September 4 by Hurricane Frances, a Category 2 hurricane with wind speeds of 105 miles per hour. Next, Hurricane Ivan struck on September 16 followed by Hurricane

Jeanne on September 26, which were both Category 3 hurricanes with respective winds speeds of 130 and 120 miles per hour at landfall. The paths of the hurricanes indicated virtually no part of Florida is immune from hurricane risk. Allegedly, the 2004 hurricanes caused damage to an estimated one in every five homes in Florida. Every county in Florida but Liberty County reported losses as a result of the 2004 hurricane season.

The four hurricanes in 2004 are responsible for 1.66 million insurance claims and $20.9 billion dollars of insured losses in the Florida market. The primary insurers incurred $11.3 billion in losses (of this amount, Citizens incurred $1.8 billion), the reinsurers incurred $5.75 billion, and the Florida Hurricane Catastrophe Fund (FHCF) incurred $3.85 billion.

For the most part, the insurance and reinsurance industry recapitalized after the 2004 hurricane season. That is, the capital lost by primary insurers and reinsurers was replenished. Additionally, the FHCF was able to pay its share of the losses out of cash reserves and maintain a cash balance to use to pay claims to start the 2005 hurricane season.

However, as the state was still recovering, recapitalizing, and rebuilding from the 2004 hurricanes, the 2005 season began. The 2005 hurricane season was also destructive for Florida, with four hurricanes hitting Florida for the second year in a row.

Hurricane Dennis hit Florida in the early part of hurricane season, making landfall on July 10, 2005, on Santa Rosa Island with maximum sustained winds of 121 miles per hour, making it a category 3 hurricane. Its center moved across the western Florida panhandle into southwest Alabama. The estimated gross property loss in Florida caused by Hurricane Dennis is close to $1.4 billion. Over 57,000 insurance claims resulted from this hurricane.

Hurricane Katrina hit Florida on August 25, 2005 and moved west across the southern portion of the state and into the Gulf of Mexico. At landfall, Hurricane Katrina was a category 1 storm with maximum sustained winds of 81 miles per hour. Although Florida did not sustain as severe damage as New Orleans, Louisiana, Biloxi, Mississippi and surrounding areas, Hurricane Katrina caused an estimated gross property loss in Florida of approximately $1.8 billion due to almost 162,000 insurance claims.

The next hurricane to hit Florida in 2005 was Hurricane Rita which made landfall on September 20, 2005. Like Hurricane Katrina, Hurricane Rita moved west across the southern part of the state with maximum sustained winds of 105 miles per hour, making it a category 2 hurricane. It is estimated Hurricane Rita caused an estimated gross property loss in Florida of $157 million due to an estimated 4,000 insurance claims.

Hurricane Wilma moved across the southern portion of Florida taking the opposite path of Hurricanes Katrina and Rita. It moved eastward across Florida from the Gulf of Mexico to the Atlantic Ocean. It made landfall on October 24, 2005, near Cape Romano, Florida with wind speeds of 121 miles per hour, a category 3 hurricane. Insured losses from Hurricane Wilma are estimated at $10.4 billion, making it the costliest hurricane for Florida in 2005. Almost 800,000 insurance claims resulted from Hurricane Wilma.

Claim and loss statistics and the loss distribution among primary insurers, reinsurance, and the Florida Hurricane Catastrophe Fund are still in development and being reported, but the four 2005 storms are estimated to have generated a combined 1 million claims and an estimated $14 billion in insured losses in Florida. As of February 28, 2006, insurers have already paid over $4 billion in insurance proceeds for claims from the 2005 hurricane season.

Insurers' losses from the 2004 and 2005 hurricanes as well as meteorological expectations that the increase in hurricane activity will continue for the foreseeable future have caused both insurers and reinsurers to reevaluate their tolerance for risk as well as the related amount of additional capital they are willing to commit to Florida. Some insurers have added new underwriting restrictions to reflect

changes in their exposure tolerance. Others have nonrenewed or cancelled policies. Still others have raised rates. In fact, since 2004 the top five insurers by market share have raised rates by an average of 28.6 percent with an average per year increase of 11.8 percent.

Since the 2005 hurricanes, the reinsurance market has partly recapitalized, but not yet fully replenished their investment capital. According to reports from the insurance industry, the reinsurance market is showing some signs that reinsurers are reconsidering the risk/return relationships available when compared with other investment opportunities. Reinsurance rates for wind reinsurance along the Gulf states are increasing for reinsurance purchased in 2006. In addition, reinsurers are increasing the retention levels for reinsurance.

Changes Proposed by the Bill

Under the bill, FIGA is authorized to contract with a city or county, or a combination of cities, counties, or cities and counties to issue tax-exempt revenue bonds for hurricane recovery. The provisions of the bill closely follow the law enacted by the 1992 Legislature to enable FIGA to pay the hurricane-related claims of insurers who became insolvent following Hurricane Andrew. As in 1993, FIGA will guarantee the tax-exempt bonds through the imposition of an emergency assessment of up to 2 percent in addition to the regular FIGA assessment of up to 2 percent. The guaranty association is authorized to charge the emergency assessment for the life of the bonds.

Definitions used in the laws that govern FIGA are amended at s. 631.54, F.S. The definition for the term "covered claim" is amended to specify that for an entity other than a person, i.e., a business or other legal entity, the residence of the entity is in the state where the entity's principal place of business is located. Under current law, for an entity other than a person, the state where the entity is incorporated is considered its state of residence. This means that an entity whose primary business location is in Florida, but that is incorporated in a state other than Florida, must seek reimbursement for unearned premiums or unpaid claims from the appropriate guaranty association of the state where the business entity is incorporated.

The powers and duties of FIGA are outlined in s. 631.57, F.S. The bill amends that law to authorize FIGA to enter into a contract with a municipality or a county, or a combination of the two, for the issuance of tax-exempt revenue bonds. Bond proceeds will be used by the city or county for hurricane recovery, although the proceeds are not required to be used exclusively within the boundaries of the issuing city or county. This means that the bond proceeds may be used by FIGA to settle unpaid claims or to refund unearned premiums to citizens of the state affected by the hurricane, even if the claimant's residence is not in the city or county that issues the bonds. Bonds may be issued by any local government substantially affected by a category 1 or stronger hurricane.

The bill authorizes FIGA to impose an emergency assessment of up to 2 percent for bond payments. The emergency assessment is in addition to the regular FIGA assessment of up to 2 percent. As with the FIGA regular assessment, the emergency assessment will be based upon an insurer's direct written premiums in the previous year, after the insurer makes any refunds. The bill specifically applies the emergency assessment only for bond payments and costs associated with their issuance. The FIGA board of directors may require the emergency assessment to be paid in a single payment or in 12 monthly installments.

Insurers are required by the bill to report their emergency assessments as part of the reports they file with OIR related to setting rates. This reporting is intended to ensure that each insurer charges premiums sufficient to satisfy its reserve requirements and to meet the other liquidity requirements in law.

The bill creates s. 631.695, F.S., relating to the issuance of revenue bonds through counties and municipalities. These provisions include several pages of legislative findings relating to the potential damage to the state if hurricane damage is not addressed and repaired quickly, especially if insurers

become insolvent due to hurricane claims. The findings acknowledge the personal hardship to persons and families who suffer losses during a hurricane and the need for claims to be settled expeditiously. Otherwise, the findings realize that great damage can occur to the economy and the citizens of the state. The findings also recognize the success of the FIGA bonds issued in 1993 and their potential for future use. The legislative findings likely will be used as part of the supporting documents that accompany any future bond issue for hurricane recovery.

The bill authorizes several uses for bonds issued for hurricane recovery. Among the authorized uses is the payment of covered claims of an insolvent insurer; to refinance or replace previous borrowings; to fund reserves for the bonds; to pay expenses incident to bond issuance; and other similar enumerated purposes. The state promises not to take any action that could endanger the availability of funds to repay the bonds. A severability clause is included in the bill.

The bill requires FIGA to file a report annually with the Senate President, the Speaker of the House, and the Chief Financial Officer. The report must specify the amount of bond proceeds used each year, the number of claims settled, and analyze the amount of emergency assessment needed to retire the bonds as promised. The bill specifies that the emergency assessment is not a premium and thus, is not subject to the premium tax, the payment of commissions, or other fees.

C. SECTION DIRECTORY:

Section 1. Amends s. 631.181, F.S., regarding the responsibility of a policyholder to file a “proof of claim” form.

Section 2. Amends s. 631.54, F.S., to modify the definition of a “covered claim”.

Section 3. Amends s. 631.57, F.S., relating to the powers and duties of the Florida Insurance Guaranty Association.

Section 4. Creates s. 631.695, F.S., relating to a local government issuing revenue bonds.

Section 5. States that no provision in ss. 631.57 or 631.695, F.S., may be repealed until all bonds issued under the laws are paid in full.

Section 6. Provides a severability clause.

Section 7. Provides that the bill shall take effect upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The authority for FIGA to serve as guarantor for local government revenue bonds following hurricane damage to the state ensures that, even if insurers become insolvent due to large numbers of claims, funds will be available to pay the valid claims of the insolvent insurer and to refund any unearned premiums to its policyholders. Under current law, FIGA deducts a fee of $100 for each claim of an insolvent insurer that is settled by FIGA.

2. Expenditures:

   The costs to FIGA for implementing the bill should be minimal. Any costs incurred for preparing and offering the revenue bonds authorized by the bill will be paid from the bond proceeds.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   Cities and counties are authorized by the bill to issue tax-exempt revenue bonds for hurricane recovery. The bonds will be repaid by FIGA using an emergency assessment of up to 2 percent on the total premiums of insurers who are members of FIGA.

   Bond proceeds may be used by a city or county substantially affected by a category 1 or stronger hurricane for rebuilding and repair of damaged structures. The proceeds will be available to a citizen whose insurer becomes insolvent following a hurricane. Bond monies will settle the valid claims of insolvent insurers and refund unearned premiums to affected policyholders.

2. Expenditures:

   A city or county that issues revenue bonds under the bill is not required to repay the bonds from its own revenues. Rather, FIGA is authorized to charge its members an emergency assessment of up to 2 percent annually, for the life of the bonds. Expenses associated with issuing the bonds will be paid from bond proceeds. This means the costs to a city or county that issues the bonds should be negligible.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Insurers who are members of FIGA will be required to pay an emergency assessment of up to 2 percent of their respective premiums for the previous year to repay the bonds. Based upon the outstanding insurance policies in Florida for 2004, a 2 percent assessment on FIGA members would cost insurers an estimated $200 million.

D. FISCAL COMMENTS:

The authority for FIGA to serve as guarantor for revenue bonds issued by a local government for hurricane recovery mirrors authority granted to FIGA by the Legislature in 1992 following the destruction to south Florida caused by Hurricane Andrew. Although there is currently no need for such bonds to be issued, granting FIGA the authority to do so should expedite hurricane recovery if the state suffers damage from one or more hurricanes in the future. The need for such bonding authority is likely to be strongest if a hurricane makes landfall in a major urban area of the state. State law prohibits FIGA from using any state monies to settle claims against an insolvent insurer.

The revenue bonds issued in 1993 by the city of Homestead enabled FIGA to settle the claims of more than six insurers who became insolvent following Hurricane Andrew. It is likely that the ability to issue such bonds again also will facilitate recovery of the state's economy should insurers suffer losses large enough to become insolvent following a hurricane.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not applicable because this bill does not appear to require cities or counties to spend funds or take actions requiring the expenditure of funds; reduce the authority that cities or counties have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with cities or counties.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

On lines 183 and192, the bill refers to the Department (of Financial Services) relating to the levy of an emergency assessment of 2 percent against FIGA members in order to retire outstanding revenue bonds for hurricane recovery. The law designates OIR as the administrative entity to levy assessments. A similar reference to the department on line 210 also should be changed to the Office of Insurance Regulation.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

None.