

**The Florida Senate**  
**BILL ANALYSIS AND FISCAL IMPACT STATEMENT**

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Appropriations

**BILL:** CS/CS/SB 1422

**INTRODUCER:** Appropriations Committee (Recommended by Appropriations Subcommittee on General Government); Banking and Insurance Committee; and Senator Simmons

**SUBJECT:** Insurer Regulatory Reporting

**DATE:** February 29, 2016      **REVISED:** \_\_\_\_\_

ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1. Johnson	Knudson	BI	Fav/CS
2. Betta	DeLoach	AGG	Recommend: Fav/CS
3. Betta	Kynoch	AP	Fav/CS

**Please see Section IX. for Additional Information:**

COMMITTEE SUBSTITUTE - Substantial Changes

## I. Summary:

CS/CS/SB 1422 revises provisions within the Insurance Code relating to solvency requirements and regulatory oversight of insurers by the Office of Insurance Regulation (OIR).

The bill implements the Risk Management and Own Risk and Solvency Assessment (ORSA) Model Act and the Corporate Governance Annual Disclosure Model Act. The model acts originated from the National Association of Insurance Commissioners' Solvency Modernization Initiative.

Specifically, the bill:

- Provides criteria for the OIR to exempt certain insurers and insurance groups and to provide waivers of ORSA requirements;
- Provides that the ORSA and Corporate Governance filings and related documents are privileged and not subject to subpoena or discovery directed to the OIR and if obtained from the office are not admissible in evidence in any private civil action;
- Authorizes the OIR to retain third-party consultants to assist in its administration of the bill and specifies requirements for such third-party consultants;
- Authorizes the Financial Services Commission to adopt rules to implement the ORSA and Corporate Governance requirements; and
- Authorizes the OIR to impose sanctions for failure to submit ORSA summary reports or Corporate Governance reports.

There is an insignificant fiscal impact to the OIR that can be handled within existing resources. The bill is effective October 1, 2016, and is contingent upon SB 1416 (Public Record Exemption) becoming law.

## **II. Present Situation:**

### **State Regulation of Insurance**

States are the primary regulators of insurance companies. The state of domicile serves as the primary regulator for insurers. Solvency regulation is designed to protect policyholders against the risk that insurers will not be able to meet their financial responsibilities. The OIR<sup>1</sup> is primarily responsible for monitoring the solvency of regulated insurers and examining insurers to determine compliance with applicable laws, and taking administrative action, if necessary. Solvency regulation includes the requirements for starting and operating an insurance company,<sup>2</sup> monitoring the financial condition of insurers through examinations and audits, and procedures for the administrative supervision,<sup>3</sup> rehabilitation,<sup>4</sup> or liquidation<sup>5</sup> of an insurance company if it is in unsound financial condition or insolvent.

### **National Association of Insurance Commissioners Model Acts**

The National Association of Insurance Commissioners (NAIC) is a voluntary association of insurance regulators from all 50 states. The NAIC coordinates regulation and examination of multistate insurers, provides a forum for addressing major insurance issues, and promotes uniform model laws among the states. The NAIC accreditation is a certification that a state insurance regulator is fulfilling legal, financial, and organizational standards. The NAIC establishes accreditation effective dates for states to adopt in substantially similar form models and acts for purposes of NAIC accreditation review. As a member of the NAIC, the OIR is required to participate in the Financial Regulation Standards and Accreditation Program. The OIR is accredited by the NAIC. The last five-year review occurred in 2013.

In response to the 2008 financial crisis, the NAIC launched the Solvency Modernization Initiative to review existing solvency oversight tools and early warning mechanisms and identify areas of potential improvement. Two of the model acts emanating from this initiative are the ORSA Model Act and the Corporate Governance Annual Disclosure Model Act.

#### ***The ORSA Model Act***

The ORSA Model Act requires insurers to conduct their own internal assessment of all reasonably foreseeable and relevant material risks (e.g., underwriting, credit, market) potentially

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<sup>1</sup> Section 20.121(3)(a), F.S.

<sup>2</sup> Sections 624.411 - 624.414, F.S.

<sup>3</sup> Administrative supervision allows the Department of Financial Services (DFS) to supervise the management of a consenting troubled insurance company in an attempt to cure the company's troubles rather than close it down.

<sup>4</sup> In rehabilitation, the DFS is authorized as receiver to conduct all business of the insurer in an attempt to place the insurance company back in sound financial condition.

<sup>5</sup> In liquidation, the DFS is authorized as receiver to gather the insurance company's assets, convert them to cash, distribute them to various claimants, and shut down the company.

affecting their ability to meet policyholder obligations. This information will provide regulators with a more comprehensive view of the ability of an insurer to withstand financial stress.

According to the ORSA Model Act and ORSA Guidance Manual, the ORSA has two primary goals: “to foster an effective level of Enterprise Risk Management...;” and “provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view.”<sup>6</sup>

The ORSA Model Act requires insurers (or an insurance group, as applicable) to:

- Maintain a risk management framework for identifying assessing, monitoring, managing and reporting on its material and relevant risks;
- Conduct an ORSA at least annually; and
- File an ORSA summary report based on the ORSA Guidance Manual with their domestic regulator or lead state (for an insurance group) beginning in 2017.

The ORSA Model Act and ORSA Guidance Manual give the insurer and insurance group flexibility with respect to the form and content of the ORSA summary report, recognizing that each insurer and insurance group’s business, strategic planning, and approach to enterprise risk management is unique. The ORSA summary reports are filed with the lead state regulator of the insurance group. Depending on the group, the OIR may or may not be the lead state regulator.

Insurers with direct premium below \$500 million and an insurance group of which the insurer is a member with premium below \$1 billion are exempt from the requirements of the ORSA Model Act. However, based on “unique circumstances,” the OIR may require an exempt insurer to file an ORSA summary report. The OIR may waive the filing requirement for non-exempt insurers.

The ORSA Model Act is an NAIC accreditation standard effective January 1, 2018. Thirty-four<sup>7</sup> jurisdictions have adopted a substantially similar version of the ORSA Model Act. Florida has not yet adopted it in any form.

### ***Corporate Governance Model Act***

During full-scope, onsite financial examinations, the OIR obtains some information on insurer governance structures, processes and practices. However, these examinations are typically limited to domestic insurers and occur only once every five years.<sup>8</sup> During the interval between these examinations, the OIR’s access to insurer governance practices is more limited. This can mask changes and activities having a substantial bearing on the financial condition of the insurer.

The Corporate Governance Model Act is designed to provide insurance regulators with sufficient information on insurer governance structures, practices, and processes through an annual disclosure. The Corporate Governance Model Act does not mandate any particular standards or procedures beyond those already provided under state law. The NAIC simultaneously adopted a

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<sup>6</sup> National Association of Insurance Commissioners, Own Risk and Solvency Assessment (ORSA) Brief, [http://www.naic.org/cipr\\_topics/topic\\_own\\_risk\\_solvency\\_assessment.htm](http://www.naic.org/cipr_topics/topic_own_risk_solvency_assessment.htm) (last visited Jan. 23, 2016).

<sup>7</sup> Office of Insurance Regulation, *Senate Bill 1422 Legislative Analysis* (Jan. 22, 2016) (on file with Banking and Insurance Committee).

<sup>8</sup> Section 624.316 (2)(a), F.S., provides that the OIR may examine each insurer as often as may be warranted for the protection of the policyholders and in the public interest, and shall examine each domestic insurer not less frequently than once every 5 years.

Corporate Governance Model Regulation that delineates the contents of the annual disclosure. Insurers or insurer groups must file a Corporate Governance Annual Disclosure with their domestic regulator or the lead state regulator (for an insurance group) no later than June 1 of each year beginning in 2017. The key items in the Corporate Governance disclosure include:

- The insurer's corporate governance framework and structure including duties and structure of the Board of Directors and its committees;
- The policies and practices of its Board of Directors and significant committees including appointment practices, the frequency of meetings held and review procedures;
- The policies and practices directing Senior Management including a description of defined suitability standards, the insurer's code of conduct and ethics, performance evaluation and compensation practices, and succession planning; and
- The processes by which the Board of Directors, its committees and senior management ensure an appropriate level of oversight to the critical risk areas impacting the insurer's business activities including risk management processes, the actuarial function, and investment, reinsurance and business strategy decision-making processes.

The Corporate Governance Model Act is expected to become an NAIC accreditation standard.<sup>9</sup> According to the NAIC, five states<sup>10</sup> have adopted a version of the Corporate Governance Model Act in a substantially similar form. Florida has not adopted it.

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

**Section 1** creates s. 628.8015, F.S., which requires insurers or insurance groups (if applicable), to file an ORSA and Corporate Governance information with their domestic regulator or lead state, beginning in 2017.

#### **Definitions**

In addition to defining "corporate governance annual disclosure," "ORSA," "ORSA guidance manual," and "ORSA summary report," the bill defines the following:

- "Insurer" is defined to have the same meaning as in s. 624.03, F.S.,<sup>11</sup> but excludes state and federal agencies, authorities, instrumentalities, possessions, territories, or political subdivisions of a state.
- "Insurance group" is defined to mean insurers and affiliates included within an insurance holding company system.
- "Senior management" is defined to mean any corporate officer responsible for reporting information to the board of directors at regular intervals or providing information to

<sup>9</sup> According to the NAIC, "The F Committee currently has out for a one year exposure the 2014 revisions to Models #305 and #306 for inclusion to the Accreditation Part A standards. The exposure period for this will end 12/31/2016. The F Committee will discuss this again at the 2017 Spring National Meeting and likely expose it for 30 days after – then consider adoption at the 2017 Summer National Meeting...if the Committee votes to adopt them into the Part A standards, the earliest it could be required for accreditation would be 1/1/19. There is a possibility the timeline could change." NAIC correspondence (Jan. 19, 2016) (on file with Senate Committee on Banking and Insurance).

<sup>10</sup> California, Indiana, Iowa, Louisiana, and Vermont have adopted the model act. Office of Insurance Regulation, *Senate Bill 1422 Legislative Analysis* (Jan. 22, 2016) (on file with Banking and Insurance Committee).

<sup>11</sup> Section 624.03, F.S., defines "insurer" to mean every person engaged as an indemnitor, surety, or contractor in the business of entering into contracts of insurance or of annuity.

shareholders or regulators. This includes, but is not limited to, a number of executives such as chief executive officer, chief financial officer, and chief risk officer.

## ORSA Provisions

The bill incorporates the three major components of the ORSA, to require insurers or insurance groups to:

- Maintain a risk management framework for identifying, assessing, monitoring, managing, and reporting on its material, relevant risks;
  - This requirement may be satisfied by being a member of an insurance group with a risk management framework applicable to the insurer's operations;
- Conduct an ORSA at least annually (and whenever there have been significant changes to the risk profile of the insurer or the insurance group), consistent with and comparable to the process in the ORSA Guidance Manual;<sup>12</sup>
- File an ORSA summary report, based on the ORSA Guidance Manual, with their domestic regulator or lead state (for an insurance group), beginning in 2017, which must:
  - Be submitted once every calendar year;
  - Include notification to the OIR of its proposed annual submission date by December 1, 2016; the initial ORSA summary report must be submitted by December 31, 2017;
  - Include a brief description of material changes and updates from the prior year's report;
  - Be signed by the chief risk officer or chief executive officer responsible for overseeing the enterprise risk management process; provide copy to board of directors or appropriate board committee; and
  - Be prepared in accordance with the ORSA guidance manual and insurer must maintain and make available for OIR examination documentation and supporting information.

## ORSA Exemption & Waiver

The bill exempts an insurer from the ORSA requirement if:

- Its annual direct written and unaffiliated assumed premium is less than \$500 million (excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program), or
- It is a member of an insurance group with an annual direct written and unaffiliated assumed premium of \$1 billion or less (excluding premiums reinsured with the Federal Crop Insurance Corporation and the National Flood Insurance Program).<sup>13</sup>

The bill also creates reporting obligations, contingent on the exempt status of the insurer and its insurance group. The OIR may still require an exempt insurer to maintain a risk management framework, conduct an ORSA, and file an ORSA summary report based on certain circumstances, such as risk-based capital that triggers a company-action-level event,<sup>14</sup> the

<sup>12</sup> The bill defines "ORSA guidance manual" as the ORSA manual developed and adopted by the NAIC. See NAIC, *ORSA Guidance Manual* (Jul. 2014), at [http://www.naic.org/store/free/ORSA\\_manual.pdf](http://www.naic.org/store/free/ORSA_manual.pdf).

<sup>13</sup> According to the OIR, two property and casualty insurer groups and five life and health insurer groups meet the ORSA threshold and have Florida as the lead state. OIR, *Q&A on ORSA and CGAD* (Nov. 15, 2015), on file with the Banking and Insurance Committee.

<sup>14</sup> Section 624.81(11), F.S., authorizes the OIR to place an insurer under administrative supervision and order corrective action if the insurer is in unsound condition, exceeds its powers granted under its certificate of authority, or its practices are

exhibition of qualities of an insurer in hazardous financial condition, or if submission of the report is in the best interests of the state. In addition, the bill allows OIR to grant a waiver to an otherwise non-exempt insurer based on unique circumstances, and specifies criteria for the OIR to consider.

## **Corporate Governance**

The bill requires insurers or insurer members of insurance groups (of which the OIR is the lead state regulator) to submit a Corporate Governance Annual Disclosure every June 1, with an initial disclosure to be submitted by December 31, 2018. The chief executive officer or corporate officer must sign the disclosure, and must describe the insurer or insurance group's governance framework and structure, relevant policies and practices, and processes for overseeing critical risk areas affecting business activities.

The bill specifies that the OIR may require the submission of the annual disclosure prior to December 31, 2018:

- Based on unique circumstances including type and volume of business written, ownership and structure, and federal and international requests.
- If the insurer meets one of the standards of an insurer deemed to be in a hazardous financial condition or exhibits qualities of an insurer in hazardous financial condition.
- If the insurer is a member of an insurance group where the OIR is the lead state regulator.
- If the OIR determines that is in the best interest of the state.

The bill allows insurers and insurance groups to provide corporate governance information at the ultimate controlling parent level, the intermediate holding company level, or at the individual legal entity level. Additionally, insurers and insurance groups may make their Corporate Governance Annual Disclosure at levels at which the insurer or insurance group 1) determines risk appetite, 2) oversees or exercises coordinated supervision of earnings, capital, liquidity, operations, and reputation of the insurer, or 3) at which legal liability would be placed for failure of general corporate governance duties. The insurer or insurance group must indicate their level of reporting and explain any subsequent changes, and may meet these requirements by referring other relevant and existing documents, such as the ORSA summary report, Holding Company B or F filings, and Securities and Exchange Commission proxy statements.

Insurers and insurance groups must report subsequent changes to the Corporate Governance Annual Disclosure. The lead state may request additional information and must review the Corporate Governance Annual Disclosure in accordance with the NAIC Financial Handbook. The insurer or insurance group must maintain and make available upon examination or request by the OIR any documentation and supporting information relating to the disclosure.

## **Privilege & Confidentiality of ORSA and Corporate Governance**

The bill provides that the ORSA and Corporate Governance filings and related documents that are submitted pursuant to this new provision, s. 628.8015, F.S., are privileged and not subject to

subpoena or discovery directed to the OIR and if obtained from the office are not admissible in evidence in any private civil action. The bill prohibits the OIR, or any person acting under the OIR's authority (such as third-party consultants), from testifying as to such filings or related documents in a private civil action. However, the OIR or the Department of Financial Services may use these filings and related documents in any regulatory or legal action it brings against an insurer as part of their official duties. The bill also provides that any applicable claims of privilege as to these filings and related documents are not waived simply because a disclosure to the OIR under this section or under any other provision of the Insurance Code. In 2014, substantially similar privilege language was enacted<sup>15</sup> for other insurer regulatory filings, regarding insurance holding company registration statements and annual enterprise risk reports<sup>16</sup> and annual actuarial opinions of reserves and supporting memoranda required of life insurers.<sup>17</sup>

### **Third-Party Consultants**

The bill authorizes the OIR to retain third-party consultants at the expense of the insurer or the insurance group for assisting the OIR with ORSA and Corporate Governance Annual Disclosure responsibilities. The bill requires these third-party consultants to adhere to confidentiality and conflict of interest standards through a written agreement with the OIR. In other areas of the Insurance Code, the OIR has authority to contract with independent external auditors or examiners under the following provisions.<sup>18</sup>

### **Rulemaking**

The bill authorizes the Financial Services Commission to adopt rules to administer the provisions of s. 628.8015, F.S.

### **Sanctions**

Currently, s. 628.803, F.S., authorizes the OIR to impose sanctions on insurers and certain affiliated individuals of insurers for certain violations. The 2014 insurer solvency legislation authorizes the OIR to place an insurer under an order of supervision and to disapprove dividends or distributions, if the OIR finds that the insurer violated s. 628.461, F.S., (acquisition of controlling stock requirements) or s. 628.801, F.S., (insurance holding company registration statement and enterprise risk reporting requirements).<sup>19</sup>

**Section 2** amends s. 628.803, F.S., to provide that the OIR may impose these fines for failure to submit an ORSA summary report or Corporate Governance Annual Disclosure, or may issue an order of supervision and disapprove dividends or distributions if an insurance company violates s. 628.8015, F.S., which is created by this bill. The OIR may impose a penalty of \$100 per day for failure to file a report, not to exceed \$10,000.

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<sup>15</sup> ch. 2014-101, ss. 8 and 11, Laws of Fla.

<sup>16</sup> Section 628.801(4), F.S.

<sup>17</sup> Section 625.1214, F.S.

<sup>18</sup> Section 624.316(2)(e), F.S., the OIR general examination authority; s. 624.3161(3), F.S., the OIR market conduct examination authority; s. 624.44(1)(c), F.S., multiple-employer welfare arrangements; and s. 641.27(2), F.S., health maintenance organization examinations.

<sup>19</sup> Section 628.803(4), F.S.; ch. 2014-101, s. 12, Laws of Fla.

**Section 3** provides the act is repealed on October 2, 2021, unless the Legislature reauthorizes the public records exemption provided in SB 1416 or similar legislation.

**Section 4** provides the act will take effect October 1, 2016, if SB 1416 or similar legislation is adopted in the same legislative session or an extension thereof and becomes a law.

**IV. Constitutional Issues:**

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

**V. Fiscal Impact Statement:**

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Under CS/CS/SB 1422, insurers may incur additional administrative costs associated with preparing and submitting the ORSA report and the Corporate Governance Annual Disclosure. However, under the provisions of the Corporate Governance Annual Disclosure, insurers and insurance groups are permitted to reference existing documents and filings. For purposes of ORSA filings, insurers are required to file the ORSA Summary reports with the lead state regulator of the insurance group, thereby avoiding regulatory redundancies associated with reporting in each state.

C. Government Sector Impact:

According to the OIR, implementation of the bill is expected to have an insignificant impact on technology systems. The OIR can accommodate the collection of any additional information through their current system.<sup>20</sup>

**VI. Technical Deficiencies:**

None.

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<sup>20</sup> Office of Insurance Regulation, *Senate Bill 1422 Legislative Analysis* (Jan. 22, 2016) (on file with the Senate Committee on Banking and Insurance.)

**VII. Related Issues:**

None.

**VIII. Statutes Affected:**

This bill substantially amends section 628.803 of the Florida Statutes.

This bill creates section 628.8015 of the Florida Statutes.

**IX. Additional Information:****A. Committee Substitute – Statement of Substantial Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**CS/CS by Appropriations on February 25, 2016:**

The committee substitute:

- Changes the date insurers must submit the annual disclosure to December 31, 2018, from December 31, 2017.
- Provides that the OIR may request the annual disclosure prior to December 31, 2018, under certain circumstances.
- Provides a contingency for repeal if the public records exemption in SB 1416 or similar legislation is not reenacted prior to expiration on October 2, 2021.
- Specifies that if the ORSA and Corporate Governance filings and related documents are obtained from the OIR, they are not admissible in evidence in any private civil action.

**CS by Banking and Insurance on January 26, 2016:**

The CS authorizes the Financial Services Commission to adopt rules; however, the adoption of such rules would be subject to the rule ratification provisions of s. 120.541(3), F.S. The CS also provides technical, conforming changes.

**B. Amendments:**

None.