Florida Insurance Report

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Florida Seeks to Adopt Holding Company Model Act

By: Travis Miller

One of the Florida Office of Insurance Regulation's ("FLOIR") priorities for the 2013 legislative session is to have the legislature adopt the National Association of Insurance Commissioners' holding company model act. Florida's holding company registration requirements have remained largely unchanged for many years and no longer are consistent with requirements being adopted in other jurisdictions after the National Association of Insurance Commissioners' promulgation of the Insurance Holding Company System Model Regulation. Both chambers of the Florida legislature have introduced bills in the current session that would give the FLOIR the necessary authority to adopt updated requirements.

Proposed Statutory Revisions

The FLOIR in the months leading up to the 2013 legislative session prepared draft legislation that would modify various statutes to conform to the model act's provisions and allow for updates to its rules. This culminated in the introduction of Senate Bill 836 in the Florida Senate, sponsored by Senator David Simmons, Chairman of the Senate Banking & Insurance Committee, and the identical House Bill 821 introduced in the Florida House of Representatives, sponsored by Representative Clay Ingram, a member of the House's Insurance and Banking Subcommittee. SB 836 has been referred to the Senate's Banking & Insurance, Judiciary and Rules committees. HB 821 has been referred to the House of Representatives' Insurance and Banking Subcommittee, Governmental Operations Appropriations Subcommittee and Regulatory Affairs Committee.

Statutory Definitions of Affiliation and Control

The bills first would create a new section 624.085, Florida Statutes, setting out several definitions to be used throughout the Florida Insurance Code. The new statute would define an "affiliate" as any entity that exercises control over or is controlled by the insurer, directly or indirectly, through equity ownership or common managerial control. The new statute likewise would define an "affiliated person" to include, among other things, relationships involving ownership of ten percent or more of another person. The term "control" is defined to mean the power to direct the management or policies of another person, whether through ownership, contract or otherwise. Control is presumed to exist if a person directly or indirectly owns, with the power to vote, ten percent or more of the securities of another person.

Continued at Top of Page 3

INSIDE THIS ISSUE....

Florida Supreme Court Substantially Restricts Economic Loss Doctrine

By: Patrick Flemming

Receding from nearly three decades of case law, the Florida Supreme Court, in *Tiara Condominium Ass'n Inc. v. Marsh & McLennan Cos.*, expressly limited the application of the economic loss rule to the area of products liability. Case No. SC10 -1002, 2013 WL 828003 (Fla. Mar. 7, 2013).

The certified question for review by the court was narrow in scope: Does an insurance broker provide a professional service such that the broker is unable to assert the economic loss rule as a bar to tort claims that arise from a contractual relationship with an insured? While the court answered the question in the negative, the court's holding carries broader implications, as the court remedied what it characterized as an "unprincipled expansion" of the economic loss rule.

The controversial 5-2 opinion, authored by Justice Labarga, traced the origin of the economic loss rule, a judicially created doctrine, to its roots in the products liability context. The rule was initially employed by Florida courts to protect "manufacturers from liability for economic damages caused by a defective product beyond that provided by warranty law." Not long thereafter, Florida courts extended the rule to the broader context of contract-based relationships. There too, the rule was used to "prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort."

The majority in *Tiara* emphasized that the expansion of the economic loss rule beyond its origins in products liability was "unwise and unworkable in practice." The court noted that the rule, and its exceptions, had been used ill-advisedly in place of fundamental contract principles. Determined to rectify what it described as an "unprincipled extension of the rule," the court receded from its prior rulings and returned to the rule's origin, holding that the "economic loss rule applies only in the products liability context."

Chief Justice Polston and Justice Canaday each penned dissents sharply criticizing the majority for its "dramatic unsettling of Florida law." While the majority's decision may align with the economic loss rule's original intent, Justice Polston noted that the decision opens a "wide arsenal of tort claims previously barred by the economic loss rule." Similarly, Justice Canaday noted that by eliminating the rule's application to situations of contractual privity, the decision opens the "prospect of every breach of contract claim being accompanied by a tort claim."

In light of this striking shift in Florida law, contracting parties should be cognizant of the possibility of now facing tort liability where the economic loss rule once provided safe harbor.

Continued from Page 1

Updates to Risk-Based Capital Requirements

The legislature next proposes to modify Florida's risk-based capital ("RBC") provisions at section 624.4085, Florida Statutes. The existing statute establishes thresholds below which an insurer or the FLOIR must develop and implement corrective measures to address financial concerns. Although the current statutes apply to life and health insurers, the pending legislative proposals would expand the RBC statute to encompass health maintenance organizations that are authorized in Florida and one or more other states as well as prepaid health service organizations that are authorized in Florida and one or more other jurisdictions. The bills would make corresponding changes to provisions granting the FLOIR regulatory authority to place insurers under regulatory control, including rehabilitation and liquidation, in the event mandatory control level events are triggered.

The bills also would change the scope of company action level events as defined in the existing section 624.4085, Florida Statutes. The bills would add that a company action level event occurs for a life and health insurer or property and casualty insurer reporting on the health insurance annual statement form if the organization has total adjusted capital that is greater than or equal to its company action level RBC but is less than the product of its authorized control level RBC and 3.0 and triggers the trend test calculation included in the RBC instructions updated annually by the NAIC. A similar requirement would extend to property and casualty insurers reporting using the property and casualty reporting form.

Annual Statement Requirements

The bills would specify that in conjunction with their annual statement filings insurers would need to provide their actuarial opinion summaries. The FLOIR has been requesting actuarial opinion summaries from insurers over the last few years as part of its general authority to investigate and examine insurers. The bills therefore might represent a clarification of the requirement and the formal adoption of protections for the information in the hands of the FLOIR rather than a new regulatory requirement. The bills would specify that the actuarial opinion summaries are exempt from Florida's broad public records laws. To properly enact an exemption to Florida's public records laws, the legislature must do so in a separate bill. SB 836 and HB 821 therefore have companion bills filed in their respective chambers confirming the important public records exemptions found in the main bills. The companion bills are discussed further below.

The bills also update the FLOIR's authority to adopt rules implementing the annual statement filing requirements. Current law allows the FLOIR to adopt rules consistent with a 1998 model rule relating to annual financial reporting. This year's legislative proposals will update this reference to the 2006 Annual Financial Reporting Model Regulation.

Acquisition Statements (Form A Filings)

The Florida Insurance Code at section 628.461, Florida Statutes, has long required acquiring parties to submit acquisition statements to the FLOIR and the target company when seeking to acquire five percent or more of a domestic insurer or its controlling parent. The filing process is commonly referred to throughout the industry as a Form A filing, although Florida's acquisition statement filing statutes contains several unique aspects that differ from other states' Form A filing processes. One difference that many acquiring parties first note is that Florida has a five percent threshold for requiring acquisition statements whereas many other states have ten percent thresholds. In addition, current Florida law allows an acquiring party to disclaim control if that party's ownership interest will not equal or exceed ten percent, but the statute does not provide for disclaimers at higher ownership percentages.

If adopted, the House and Senate bills would make several changes to the acquisition statute. These include:

Continued on next page

Holding Company Model Act

Continued from Page 3

a. Requiring an acquiring party to assert that it will file the enterprise risk report newly required under section 628.801(2), Florida Statutes, if control exists;
b. Requiring an acknowledgment by the acquiring party that it and its subsidiaries will file information necessary for the FLOIR to evaluate enterprise risk.
c. Allowing an acquiring party to rebut a presumption of control by filing a disclaimer statement. The acquiring party then would be relieved of registering or reporting under Section 628.461, Florida Statutes, unless the FLOIR disallows the disclaimer. Unlike the current statute, this new provision is not necessarily limited to direct or indirect acquisitions of less than ten percent of voting interests in domestic insurers;
d. Requiring a controlling person to provide notice of its intent to divest control unless the transaction in which the divesture would occur is the subject of an acquisition statement filing.
e. Eliminating definitions of "affiliated person" and "controlling company." These are no longer necessary because the bills create the new section 624.085 discussed above.

A new provision added to Section 628.803, Florida Statutes, would specify that if any person violates Section 628.461, Florida Statutes, in a manner that prevents the FLOIR's full understanding of an organization's enterprise risk, the violation constitutes independent grounds for disapproving dividends or distributions or placing the insurer under an order of administrative supervision.

With the proposed amendments, Florida's general acquisition statement filing requirement will remain intact for transactions involving five percent or more of the voting interests in domestic insurers or their controlling persons. However, the disclaimer of control provisions will be new and more similar to those found in other states. In addition, persons with controlling interests in domestic insurers or their parents will need to familiarize themselves with the new divestiture notice provisions.

Insurance Holding Company Statutes

Under an amendment to section 628.801, Florida Statutes, insurers would be required to submit their holding company registration statements by April 1 of each year. The FLOIR currently requests that insurers submit holding company registration statements with their annual statement filings by March 1 of each year. Allowing the filings to be made by April 1 may be helpful to insurers' accounting and compliance staffs as the days and weeks leading up to the current March 1 deadline are consumed by preparing annual statements and related obligations. Another proposed statutory change will ensure that insurers file material transactions with their affiliates according to a rule promulgated by the FLOIR.

The 2013 legislative proposals also will add a new subsection (2) to Section 628.801, Florida Statutes. The new subsection will require the ultimate controlling person of every insurer filing a registration statement to submit an enterprise risk report by April 1 of each year. The report is to be filed with the lead state office of the holding company system as determined in accordance with the NAIC's Financial Analysis Handbook. The report must identify to the best of the reporting person's knowledge and belief the material risks within the holding company system that could pose enterprise risk to the insurer. For purposes of the statute, "enterprise risk" means any activity or event involving one or more affiliates of an insurer that, if not remedied promptly, would be likely to have a material adverse effect on the financial condition or liquidity of the insurer or the holding company system as a whole. This includes any circumstance that would cause the insurer's risk-based capital to fall into the company action level or would cause the insurer to be in hazardous financial condition. The bills further would extend the FLOIR's general examination authority under Chapter 624, Florida Statutes, to the insurer and affiliates for the purpose of ascertaining the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling person or any combination of persons within the holding company system.

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Additional Proposed Law Changes

The bills would add a new section 628.805, Florida Statutes, to allow the FLOIR to organize and participate in supervisory colleges. The new statute would allow the FLOIR to participate in any supervisory college, initiate the establishment of a supervisory college, and coordinate activities of the supervisory college. A supervisory college may be formed as a temporary or permanent forum for cooperation among regulators charged with supervising an insurer or its affiliates. The FLOIR's costs of participating in a supervisory college may be assessed to the insurer involved.

The bills also would amend Section 636.045, Florida Statutes, governing prepaid limited health service organizations to confirm they are subject to Florida's RBC requirements if they are authorized in one or more jurisdictions in addition to Florida. The legislature would make a similar change for health maintenance organizations at Section 641.225, Florida Statutes, and further would specify that any such health maintenance organization would be subject to the new acquisition statement requirements of Section 628.461, Florida Statutes, instead of the similar requirements of Section 628.4615, Florida Statutes, that currently apply to specialty insurers.

Senate Bill 834 serves as a companion public records bill in the Senate and HB 821 is the corresponding bill in the House of Representatives. Both main bills specify that they will take effect on October 1, 2013, as long as the corresponding public records exemption bills become law. The public records exemption bills specify that "proprietary business information" held by the FLOIR is confidential and exempt from disclosure under Florida's very broad public records laws. The bills define proprietary business information to include any information, regardless of form, that is intended by the insurer to be private because its disclosure would cause harm to the organization and that has not been otherwise disclosed except pursuant to other confidential processes. The bills indicate that proprietary business information may include, but is not limited to disclosure, of the source of consideration in the acquisition or merger of an insurer, information about bids or contracts that would impair the ability of an insurer or affiliates to obtain goods or services on favorable terms, and internal auditing controls and reports of internal auditors. The bills further indicate that proprietary information may be found in actuarial opinion summaries, divestiture reports filed in accordance with the new provisions of Section 628.461, Florida Statutes, and enterprise risk reports. In addition, the FLOIR may obtain proprietary business information through its participation in supervisory colleges and through the sharing of information with other governmental entities or the NAIC.

Conclusion

Florida's holding company laws do not fully address issues contained in more modern holding company regulations such as providing actuarial opinion summaries and enterprise risk reports and requiring notice of divestitures of controlling interests. If passed, SB 836 and HB 821 will ensure the FLOIR has this authority and meets NAIC accreditation standards in these areas. In addition, the bills along with their public records law companions will provide necessary protections for insurers providing confidential information to the FLOIR.

To monitor the progress of SB 836, HB 821 and the related bills during the legislative session, please see the legislative updates provided at www.radeylaw.com.

Legislature Continues to Wrestle with Citizens Reforms

By: Travis Miller

It is always difficult to predict halfway through a legislative session whether a particular proposal will pass. With reforms affecting Citizens Property Insurance Corporation, it's nearly impossible. Both chambers of the legislature have been debating Citizens reforms for several weeks, but we're no closer to knowing how this will turn out than when we began.

The challenges facing Citizens are illustrated by the results of an insurance committee meeting a few weeks ago. Several members of the House of Representatives insisted that Citizens should immediately begin charging actuarially sound rates for new business while maintaining the glide path rates for existing business. Other legislators immediately followed by filing bills specifying that Citizens must not charge a different rate for new business than for existing business. Policymakers' views regarding Citizens often are strongly held, and often are in direct conflict.

Several ideas have surfaced in the current session that might help alleviate Citizens' continued growth at the rate of about 8000 policies for week. One idea would preclude policyholders from remaining in Citizens if they receive offers from assuming carriers at rate levels no more than 5% greater than their existing rates. Other legislators have suggested gradually stepping down the maximum Coverage A limit under Citizens policies, perhaps going as low as $500,000 over several years.

The legislature also is considering incentives for insurers to remove policies from Citizens. Last year Citizens considered using some of its accumulated surplus to provide surplus notes to assuming insurers. Citizens eventually abandoned the proposal, in part due to questions expressed by legislators about its ability to do so. The legislature could authorize Citizens to adopt this type of program or other incentives.

Eventually we might have a legislative session in which key property insurance bills do not go down to the wire. Unfortunately, it doesn't look it will be this year.

CAT Fund Right-Sizing Proposal Unresolved as Session Nears Mid-Point

By; Travis Miller

Last year the Florida Hurricane Catastrophe Fund (FHCF) advocated a reduction in its capacity over several years in an effort to better ensure it can meet its projected claims-reimbursement obligations. However, the proposal ultimately did not pass because the significant reductions in the FHCF were expected to create upward pressure on rates beyond levels lawmakers considered palatable.

This year, the FHCF has advocated for a smaller series of reductions that still would improve the FHCF's likelihood of being able to meet reimbursement obligations while moderating any rate impact. Despite the scaled-down proposal, though, it is not clear whether the legislature is prepared to start shrinking the FHCF anytime soon.

The so-called "right-sizing" proposal is supported by interests ranging from business groups, which are interested in reducing their potential assessment burden, to environmental groups, which assert that the state should not be subsidizing continued development of coastal areas. Lawmakers on the other hand continue to have reservations about taking steps that will increase rates to consumers. The amounts may be small relatively speaking, but reducing the coverage provided by the FHCF will cause insurers to replace that coverage in the private market, generally at an increased cost that must be passed on to consumers.

Jay Neal, a consumer advocate, offered an interesting observation on the issue that should receive more attention too. He suggested that perhaps the best way of shoring up the FHCF is to address concerns with Citizens Property Insurance Corporation. Citizens is by far the largest participant in the FHCF, and Mr. Neal's comment underscores the broader principle that the residential property market should be viewed as a whole and potential solutions to existing concerns should be coordinated.

OIR Releases 2013 Freedom to Travel Report

By: Karen Asher-Cohen

Commissioner Kevin McCarty submitted the OIR's "2013 Report on Life Insurance Limitations Based on Foreign Travel Experiences" to the Florida Legislature. The Report outlines the implementation of and compliance with the Freedom to Travel Act, which was passed in 2006. Pursuant to section 626.9541(1)(dd), Florida Statutes, it is an unfair trade practice in Florida for a company to deny or discontinue life insurance coverage for an individual based solely on that person's past or future lawful travel.

"This is the seventh year of this report and it highlights the success of legislative and regulatory actions taken to prevent unfair discrimination for life insurance and annuities policyholders and applicants," said Commissioner McCarty. "We appreciate the insurance industry's cooperation with this important legislation preserving Floridians' rights to travel freely outside of the United States."

First DCA Affirms OIR's Position on Sinkhole Loss Coverage Minimum

By: Patrick Flemming

While it is undisputed that Florida property insurers are required to offer sinkhole loss coverage, the extent of such coverage required to be offered was less clear—until now. The First District Court of Appeal recently affirmed a determination by the Office of Insurance Regulation ("OIR") interpreting section 627.706(1), Florida Statutes, to require Florida property insurers to offer sinkhole loss coverage in an amount equal to the casualty coverage provided for in the base policy. *Florida Farm Bureau Casualty Ins. Co. v. Office of Ins. Regulation*, No. 1D12-2265, 2013 WL 950549 (Fla. 1st DCA Mar. 13, 2013).

Florida Farm Bureau ("Farm Bureau") sought OIR's "approval of a proposed amendment to its endorsement limiting sinkhole coverage to 25 percent of the overall coverage amount for the insured dwelling." OIR rejected the proposal, concluding that Farm Bureau's proposed sinkhole coverage policy would violate section 627.706(1), Florida Statutes. That section requires each "insurer authorized to transact property insurance" to also make available "coverage for sinkhole losses on any structure . . . *to the extent provided in the form to which the coverage policy attaches*." § 627.706(1)(b), Fla. Stat. (2011). OIR interpreted the term "form"—to which sinkhole loss coverage attaches—to mean the base property insurance policy, resulting in a determination that Farm Bureau's proposed sinkhole loss coverage was insufficient.

Farm Bureau sought review of OIR's determination, and on appeal, Judge Marstiller upheld OIR's interpretation of section 627.706(1)(b) as being within the range of permissible interpretations and, therefore, not clearly erroneous. The court noted that since section 627.706(1)(b) ties sinkhole loss deductibles to a percentage of the policy dwelling limits, it was reasonable for OIR to "conclude that the amount of sinkhole loss coverage is intended to be the same as the amount of casualty coverage provided for in the base policy." Further, the court noted that the statutory references to specific deductible amounts buttressed OIR's position that its interpretation "ensures property owners have available to them meaningful sinkhole loss coverage." Finally, the court found no evidence that recent statutory changes to section 627.706 undermined OIR's position. For these reasons, the court affirmed OIR's decision and, by doing so, clarified the duties imposed on Florida's property insurers.

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