

STORAGE NAME: h0541.in

DATE: February 11, 2000

**HOUSE OF REPRESENTATIVES
COMMITTEE ON
INSURANCE
ANALYSIS**

BILL #: HB 541

RELATING TO: Life Insurance

SPONSOR(S): Representative Goode

TIED BILL(S):

ORIGINATING COMMITTEE(S)/COMMITTEE(S) OF REFERENCE:

- (1) INSURANCE
 - (2) GOVERNMENTAL RULES & REGULATIONS
 - (3) GENERAL GOVERNMENT APPROPRIATIONS
 - (4)
 - (5)
-

I. SUMMARY:

This bill makes several changes to Florida law relating to life insurance. These include:

- authorizing the Division of Risk Management to directly purchase annuities for the purpose of entering into structured settlements;
- modifying the method of calculating the deficiency reserve for renewable term life insurance policies;
- updating the buyer's guide required to be used by insurers soliciting life insurance business; and
- authorizing the Department of Insurance to adopt by rule the model rules for the valuation of life insurance policies adopted by the National Association of Insurance Commissioners in March 1999.

The bill also makes one change to Florida law relating to health insurance. In 1997, to comply with the federal Health Insurance Portability and Accountability Act, Florida enacted several provisions, including s. 627.6487, F.S., which guarantees the availability of individual health insurance coverage to individuals with certain prior creditable coverage. Under the bill, only coverage provided in Florida could count as creditable coverage for purposes of s. 627.6487, F.S. This provision raises constitutional questions. See the "Constitutional Issues" section of the analysis.

The bill would have no fiscal impact on local government. But, the bill would have a fiscal impact on state government of an indeterminate amount. See the "Fiscal Comments" section of the analysis.

II. SUBSTANTIVE ANALYSIS:

A. DOES THE BILL SUPPORT THE FOLLOWING PRINCIPLES:

- | | | | |
|-----------------------------------|---|-----------------------------|---|
| 1. <u>Less Government</u> | Yes <input checked="" type="checkbox"/> | No <input type="checkbox"/> | N/A <input type="checkbox"/> |
| 2. <u>Lower Taxes</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 3. <u>Individual Freedom</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 4. <u>Personal Responsibility</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |
| 5. <u>Family Empowerment</u> | Yes <input type="checkbox"/> | No <input type="checkbox"/> | N/A <input checked="" type="checkbox"/> |

For any principle that received a "no" above, please explain:

B. PRESENT SITUATION:

Aspects of the present situation addressed by the bill are described in the "Section-by-Section Analysis" below.

C. EFFECT OF PROPOSED CHANGES:

The bill would affect several provisions of law relating to insurance. As described in more detail in the "Section-by-Section Analysis":

- The Division of Risk Management would be authorized to contract, pursuant to Chapter 287, F.S., with an insurance consultant through whom the state could directly purchase annuities for structured settlements. Thus, the Division of Risk Management would no longer be subject to the procurement requirements of Chapter 287, F.S., every time it needed to purchase an annuity for a structured settlement. The insurance consultant would be selected through the competitive bidding or proposal process.
- The deficiency reserves for renewable term life insurance policies would be calculated in accordance with the model NAIC regulations for the valuation of life insurance policies and, as such, would take into account subsequent terms.
- Insurers soliciting life insurance business would be required to use the buyer's guide adopted by the NAIC on October 1, 1996.
- The Department of Insurance would be authorized to adopt by rule the model rules for valuation of life insurance policies as adopted by the NAIC in March 1999.
- Only coverage provided in Florida would count as creditable coverage for purposes of guaranteed availability of individual health insurance under s. 627.6487, F.S. This provision raises constitutional questions. See the "Constitutional Issues" section of the analysis.

D. SECTION-BY-SECTION ANALYSIS:

Section 1: Amends s. 284.33, F.S.

PRESENT SITUATION:

Florida Casualty Insurance Risk Management Trust Fund

Part II of Chapter 284, F.S., creates a trust fund, called the Florida Casualty Insurance Risk Management Trust Fund, for the purpose of providing casualty insurance for the State of Florida. The trust fund covers all departments of the State of Florida and their employees, agents, and volunteers.¹ The Department of Insurance, Division of Risk Management administers this trust fund.

The Florida Casualty Insurance Risk Management Trust Fund provides insurance to the State of Florida for:

- workers' compensation;
- general liability;
- fleet automotive liability;
- federal civil rights actions (42 U.S.C. s. 1983 and similar statutes); and
- attorneys fees in certain other proceedings against the state.

To provide these various coverages, Florida law authorizes the Department of Insurance to purchase insurance and reinsurance through the Department of Management Services, pursuant to state procurement requirements.² The law also allows the Department of Insurance to purchase risk management services, including claims control, investigation, claims adjustment, and legal services.³

State Procurement Requirements

Chapter 287, F.S., sets forth the requirements the state must follow in purchasing commodities and contractual services. Under Florida law, insurance is not considered a commodity, but it is required to be purchased in the same manner as a commodity.⁴ When purchasing insurance for the state risk management program, the Department of Management Services must follow the invitation to bid or request for proposal process.⁵ According to the Division of Risk Management, this process can take several months to complete.

Structured Settlements

An arrangement to satisfy a legal liability which involves the periodic payment of money through an annuity (or other financial product) is generally referred to as a structured

¹ Section 284.31, F.S.

² Section 284.33(1), F.S.

³ Id.

⁴ See s. 287.022(1), F.S.

⁵ See s. 287.057(1) & (2), F.S.

settlement. Under a structured settlement involving an annuity arrangement, one party pays a lump sum premium to an insurance company to purchase an annuity in the name of the claimant. The premium varies depending on the number and length of payments. The insurance company then makes periodic payments to the claimant for the negotiated period of time.

Structured settlements are commonly used as an alternative to simple lump sum settlements. Structured settlements can offer some advantages to both parties involved in the settlement. For claimants, a structured settlement can provide assurance of future income, which may be necessary for claimants with long term medical needs. Also, money paid to a claimant through a structured settlement receives more favorable federal tax treatment. Unlike investment earnings on a lump sum payment, which are taxable, payments made under a structured settlement are not taxable. However, claimants must weigh these advantages against the disadvantage of not having access at any one time to the entire amount of money received in the settlement.

For the paying party, structured settlements can provide a more cost effective means of extinguishing the legal liability. For example, a \$2 million lump sum payment would cost \$2 million. However, \$2 million paid over time through a structured settlement might be accomplished through purchasing an annuity that costs only \$500,000 -- a savings of \$1.5 million.

EFFECT OF SECTION:

This section authorizes the Division of Risk Management to contract with a "structured settlement insurance consultant" to act as an agent of record of the state and to assist in the direct purchasing of annuities for structured settlements. Under this section, the Division of Risk Management would be authorized to pay a premium to an insurance company to purchase an annuity. Then, the insurance company would make periodic payments to the claimant.

The insurance consultant would be selected in accordance with the state's procurement requirements. This section sets forth the criteria the consultant must consider in procuring annuities, including price, financial strength of the insurer, and the best interest of the state risk management program. Finally, this section exempts from the state procurement requirements the purchase of annuities through the structured settlement insurance consultant.

Section 2: Amends s. 625.121, F.S.

PRESENT SITUATION:

Life Insurance

Life insurance is the insurance of human lives. Life insurance contracts can take four basic forms: term; whole life; endowment; and annuities.

Term Life Policy - A policy that furnishes life insurance protection for a limited number of years. The value of the policy is paid only if the death occurs during the contract term, and nothing is paid if the insured survives the term.⁶

Whole Life Policy - A policy that provides for the payment of the face value of the policy upon the death of the insured, regardless of when it occurs. The most common whole life policy is the straight life policy, which assumes premiums will be paid throughout the life of the insured.⁷

Endowment Policy - A policy that is similar to a term life policy in that it pays a fixed benefit upon the death of the insured during a specified term, but different in that it pays a benefit at the end of the term if the insured is still living.⁸

Annuity - A contract where, for cash consideration, one party (the insurer) agrees to pay the other (the annuitant) a stipulated sum of money for a specified period of time, which can be a set number of years or for the life of the annuitant. Annuities are generally referred to as either immediate or deferred. Immediate annuities are purchased with a single premium and immediately begin paying benefits on a regular basis. Deferred annuities are structured so premium payments accumulate interest until a designated date for payments to begin.⁹

Life Insurance Reserves

Generally

Life insurance contracts are written on a level-annual-premium basis, that is, the same amount of premium is paid throughout the life of the policy. This means that premiums collected near the beginning of the policy are higher than necessary to pay claims in those years, while premiums paid in the later years of the policy are insufficient to pay claims in those years. As a result, the premiums collected in the early years of the policy, which exceed current-year requirements, must be accounted for and held for payment of future benefits. This money is called the basic policy reserve.

Therefore, if an insurer has reserved correctly:

the policy reserve + future premiums = enough money to pay future benefits.

Florida law establishes a formula which determines how much of the gross premiums collected by the insurer must be held as the basic policy reserve.

Occasionally, insurers will charge premiums which are lower than the premiums that standard mortality tables suggest they should charge. When this occurs, the basic policy reserve held by the insurer may be inadequate. To ensure that there

⁶ ARTHUR ANDERSON & CO., THE INSURANCE INDUSTRY, AN INTRODUCTION, 60 (1991).

⁷ *Id.* at 61-62.

⁸ *Id.* at 64.

⁹ *Id.* at 64-65.

is sufficient money to pay claims, insurers are required to reserve additional premiums. This is called a "deficiency" reserve.

The deficiency reserve equals the difference between the premiums insurers actually charge and the premium the applicable mortality tables suggest they should charge.

Current law directs the insurer to calculate deficiency reserves for renewable term life insurance policies by using the current term period only -- excluding the subsequent terms which could occur after renewal.

Standard Valuation Law - National Association of Insurance Commissioner's (NAIC) Model Act and Florida

The NAIC has adopted a model act, called the Standard Valuation Law, for the valuation of life insurance policies and the calculation of basic policy reserves and deficiency reserves. The most recent revision of the NAIC model act was in January 1997. Virtually every state in the country, including Florida, has adopted a variation of the NAIC model act.

Section 625.121, F.S., is Florida's "Standard Valuation Law." Section 625.121(7), F.S., provides the method for calculating the basic policy reserve. Section 625.121(11), F.S., provides the method for calculating the deficiency reserve.

NAIC Model Regulations for the Valuation of Life Insurance Policies Including Tables of Select Mortality Factors

To implement the NAIC model act, the NAIC has adopted a set of model rules, which include tables of select mortality factors. The most recent version of these model rules was adopted by the NAIC in March 1999.

The NAIC model rules take into account the subsequent terms of a renewable term life insurance policy when calculating the deficiency reserve. This is different than the approach currently taken under Florida law, which only takes into account the current term period.

EFFECT OF SECTION:

This section would require deficiency reserves for renewable term life insurance policies to be calculated in accordance with the deficiency reserve provisions of the NAIC model rules, which take into account subsequent renewable terms.

Section 3: Amends s. 626.99, F.S.

PRESENT SITUATION:

Florida law regulates insurers' sale of life insurance to purchasers in the state. The purpose of this law is to provide information to purchasers which will improve the buyers ability to select the most appropriate plan of life insurance, improve the buyers' understanding of the basic features of the policy, and improve the buyer's ability to

evaluate the relative costs of similar plans of life insurance.¹⁰ To achieve this purpose, the law requires insurers to adopt and use a buyer's guide. Current law provides that the adoption and use of the buyer's guide adopted May 4, 1976, by the NAIC constitutes compliance with the law.

EFFECT OF SECTION:

This section changes the date of the NAIC-approved buyer's guide that insurers may use when soliciting life insurance business. This section replaces the version approved by the NAIC May 4, 1976, with the version approved by the NAIC October 1, 1996. See the "Other Comments" section of the analysis for a discussion of the change in the title of the NAIC model regulation containing the buyer's guide.

Section 4: Creates s. 627.4785, F.S.

PRESENT SITUATION:

Currently, the Department of Insurance has not adopted any administrative rules relating to the valuation of life insurance policies.

EFFECT OF SECTION:

This section would authorize the Department of Insurance to adopt by rule the model regulations for the valuation of life insurance policies, including tables of select mortality factors, as approved by the NAIC in March 1999. This section would also authorize the Department of Insurance to make the rules effective January 1, 2000.

Section 5: Amends s. 627.6487, F.S.

PRESENT SITUATION:

Health Insurance Portability and Accountability Act (HIPAA)

In 1996, Congress enacted the federal Health Insurance Portability and Accountability Act (HIPAA) to provide guaranteed availability and renewability of health insurance coverage for certain employees and individuals, and to increase portability of insurance through the limitation on preexisting condition exclusions. "Portability" in HIPAA means that once you have health coverage, this coverage may be used to reduce or eliminate any preexisting condition exclusion that might be applied to you under a future plan or policy.¹¹ The concept of portability is one of receiving credit for maintaining health coverage, even though it may be under different health plans or policies.¹²

The HIPAA allowed each state the option of enacting and enforcing the federal provisions or relying on federal enforcement. The HIPAA specifies that the federal provisions pertaining to health insurers in the individual market generally do not preempt state regulation of individual insurers. If the state's statutory provisions

¹⁰ Section 626.99(1), F.S.

¹¹ HIPAA Frequently Asked Questions, HIPAA page of the Health Care Financing Administration web site (www.hcfa.gov/hipaa/hipaahm.htm).

¹² Id.

prevent the application of a federal requirement, the HIPAA preempts the statutes and the federal requirements prevail. Each state must ensure that its provisions comport with HIPAA and do not diminish the federal requirements. Each state was permitted to adopt provisions that expand or provide more favorable treatment for the individual.

Guaranteed Availability of Individual Health Insurance

In 1997, to comply with the HIPAA, the Florida Legislature enacted a provision which guaranteed the availability of health insurance coverage for eligible individuals.¹³ Under Florida law, an "eligible individual" is an individual:

- (a) 1. who has at least 18 months of prior creditable coverage; and
 2. a. whose most recent prior creditable coverage was under a group plan, governmental plan, or church plan; or
 - b. whose most recent prior creditable coverage was under an individual plan issued by an insurer or HMO, which coverage was terminated because the insurer or HMO became insolvent or because the insured no longer lives in the service area of the network;
- (b) who is not eligible for coverage under a group health plan, a conversion policy, Medicare, or Medicaid, and does not have other coverage;
- (c) whose most recent prior coverage was not terminated based on the nonpayment of premiums or fraud;
- (d) who, having been offered the option of continuation coverage under the Consolidated Omnibus Budget Reconciliation Act (COBRA), elected such coverage; and
- (e) who has exhausted such continuation coverage under COBRA.¹⁴

Insurers that offer group health insurance coverage are required under the HIPAA (and Florida law) to provide an individual who loses coverage with a certification of the individual's prior creditable coverage. The certificate enables an individual to determine whether they are eligible for individual health insurance coverage guaranteed by the HIPAA and Florida law.

EFFECT OF SECTION:

This section would limit the portability of coverage since creditable coverage provided outside the State of Florida would not count for purposes of Florida's guaranteed availability of individual health insurance coverage. Under this section, only health insurance coverage provided in the State of Florida, whether it be group or individual, could be counted as

¹³ Chapter law 97-179, s. 4, Laws of Florida.

¹⁴ See s. 627.6487(3), F.S. It should be noted that subparagraph 2.b. of s. 627.6487(3)(a), F.S., which allows certain *individual* health insurance coverage to count as creditable coverage, was not required to be enacted under the HIPAA. The federal HIPAA only considers prior *group* coverage as creditable coverage. This provision, which was added in 1998, is more generous than HIPAA in that it expands the types of coverage which would count as creditable coverage.

credible coverage. This section raises constitutional questions. See the "Constitutional Issues" section of the analysis.

III. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT:

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

The bill could result in reduced expenditures by the state of an indeterminate amount. See Fiscal Comments.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill changes the way the deficiency reserve is calculated for renewable term life insurance policies. Current law requires the insurer to calculate the deficiency reserve on renewable term life insurance policies by using the current term period only. Thus, if an insured is five years into a 10-year renewable term policy, the deficiency reserve would be calculated using the remaining five years of the current term. However, under the NAIC model rules the deficiency reserve would take into account subsequent terms for which the insured is allowed to renew. Thus, using the example above, if the insured has guaranteed renewability for two additional terms, the remaining 25 years would be taken into account in calculating the deficiency reserve. As a result, the bill could result in insurers having to reserve more money that they are required to under current law.

However, the cost of reserving more money on renewable term life insurance policies could be outweighed by the benefit of adopting the NAIC regulations which establish a more uniform method of valuation of life insurance policies nationwide.

D. FISCAL COMMENTS:

The bill authorizes the Division of Risk Management to purchase annuities through a consultant for the purpose of entering structured settlements. This could enable the Division of Risk Management to settle claims against the state for less money than a traditional lump sum settlement. The amount of these savings is indeterminate. Not all claims are appropriate for structured settlement. Smaller claims may be such that the administrative costs associated with a structured settlement negate any savings achieved through the purchase of an annuity. Additionally, some claimants may refuse to enter into

structured settlements. Therefore, it is not possible to provide an accurate projection of savings to the state.

But, the following hypothetical illustrates the potential difference between a lump sum settlement and a structured settlement. Assume a claimant agreed to settle a case for \$2 million. A lump sum settlement would cost the Division of Risk Management \$2 million. But, a \$2 million settlement paid out over time by an insurance company through an annuity might only cost the Division of Risk Management \$500,000 in premium -- a savings of \$1.5 million.

IV. CONSEQUENCES OF ARTICLE VII, SECTION 18 OF THE FLORIDA CONSTITUTION:

A. APPLICABILITY OF THE MANDATES PROVISION:

This bill does not require counties or municipalities to spend funds or to take an action requiring the expenditure of funds.

B. REDUCTION OF REVENUE RAISING AUTHORITY:

This bill does not reduce the authority that counties or municipalities have to raise revenues in the aggregate.

C. REDUCTION OF STATE TAX SHARED WITH COUNTIES AND MUNICIPALITIES:

This bill does not reduce the percentage of a state tax shared with counties or municipalities.

V. COMMENTS:

A. CONSTITUTIONAL ISSUES:

Section 5 of the bill states that only group and individual coverage provided in the State of Florida counts toward creditable coverage for purposes of s. 627.6487, F.S. The HIPAA, however, does not limit prior group coverage to coverage provided in any one state. The HIPAA broadly defines creditable coverage as coverage of the individual under any of the following:

- (A) A group health plan.
- (B) Health insurance coverage.
- (C) Part A or part B of title XVIII of the Social Security Act.
- (D) Title XIX of the Social Security Act, other than coverage consisting solely of benefits under section 1928.
- (E) Chapter 55 of title 10, United States Code.
- (F) A medical care program of the Indian Health Service or of a tribal organization.
- (G) A State health benefits risk pool.
- (H) A health plan offered under chapter 89 of title 5, United States Code.
- (I) A public health plan.¹⁵

¹⁵ See 42 U.S.C. Section 300gg(c)(1).

The portion of section 5 amending s. 627.6487(3)(a)2.a., F.S., raises an issue as to whether an in-state limitation on creditable coverage is more restrictive than the HIPAA and, as a result, might be preempted by federal law.

The HIPAA does not count prior *individual* health insurance coverage as creditable coverage, as Florida's more generous law does in s. 627.6487(3)(a)2.b., F.S. Thus, it could be argued that the portion of section 5 amending s. 627.6487(3)(a)2.b., F.S., to create an in-state limitation is not more restrictive than HIPAA and, accordingly, would not be preempted.

In addition, the bill may raise an issue relating to the constitutionally protected right to travel among the states. The bill requires a person to have 18 months creditable coverage "in this state" before having the right to guaranteed availability of individual health insurance coverage. It could be argued that this provision amounts to an impermissible durational residency requirement, similar to the ones struck down by the United States Supreme Court relating to welfare benefits and medical care.¹⁶

B. RULE-MAKING AUTHORITY:

The bill authorizes the Department of Insurance to adopt by rule the model regulations for valuation of life insurance policies as adopted by the NAIC in March 1999. The bill also specifically authorizes the Department to make the rules retroactive to January 1, 2000.¹⁷

C. OTHER COMMENTS:

Title

The bill is entitled "An act relating to life insurance." However, section 5 of the bill deals with guaranteed availability of individual health insurance coverage. The title of the bill does not reflect the broader range of issues contained in the bill.

Structured Settlements

The bill only authorizes the Division of Risk Management to purchase annuities for the purpose of entering into structured settlements. The bill does not authorize the Division of Risk Management to purchase other financial products through which a structured settlement could be entered.

NAIC Life Insurance Disclosure Model Regulations

In addition, in s. 626.99, F.S., current law refers to the "NAIC Life Insurance Solicitation Model Regulation." The title of this particular NAIC model regulation has since been

¹⁶ See Shapiro v. Thompson, 394 U.S. 618, 89 S.Ct. 1322, 22 L.Ed.2d 600 (1969); Memorial Hospital v. Maricopa County, 415 U.S. 250, 94 S.Ct. 1076, 39 L.Ed.2d 306 (1974); Attorney General of New York v. Soto-Lopez, 476 U.S. 898, 903, 106 S.Ct. 2317, 2321, 90 L.Ed.2d 899 (1986) (state law implicates the fundamental right to travel and therefore triggers strict scrutiny: (1) when impeding interstate travel is its primary purpose; (2) when its uses a classification which serves to penalize the right to travel; or (3) where it actually deters such travel); see also Maldonado v. Houston, 177 F.R.D. 311, (E.D.Pa. 1997) ("[T]he purpose of preventing the Commonwealth from becoming a welfare magnet is constitutionally impermissible.").

¹⁷ Since the bill expressly authorizes making the rules retroactive to January 1, 2000, the prohibition against retroactive rules does not apply. See s. 120.57(1)(f), F.S.

changed to the NAIC "Life Insurance *Disclosure* Model Regulation." An amendment could be offered to update current law.

Placement of the Newly Created s. 627.4785, F.S.

This bill creates s. 627.4785, F.S., in order to grant the Department of Insurance the authority to adopt by rule the NAIC Model Regulations on Valuation of Life Insurance Policies. This section is created in Part III of Chapter 627, F.S., relating to life insurance and annuity contracts. However, the existing law on the subject of valuation of life insurance policies is located in Part I of Chapter 625, F.S., relating to the assets and liabilities of insurers. Since the NAIC Model Regulations deal with the same subject matter that is in s. 625.121, F.S., this new section could be created as a subsection of s. 625.121, F.S.

Definition of "Eligible Individual"

Section 627.6487(3), F.S., defines the term "eligible individual" for purposes of guaranteed availability of individual health insurance coverage. To meet the current definition of "eligible individual," one must meet the criteria of paragraphs (a), (b), (c), (d), and (e). The revisions proposed in the bill would delete semicolons on page 5, line 22 and on page 6, lines 5, 11, and 14 and would delete the word "and" on page 6, line 14. As a result, the bill could be construed as modifying the definition of "eligible individual" so that a person need only meet one of the criteria listed in (a) - (e). If this is not the intent of the sponsor, an amendment could be offered to retain current law so that one must meet all of the paragraphs to be considered an "eligible individual."

VI. AMENDMENTS OR COMMITTEE SUBSTITUTE CHANGES:

N/A

VII. SIGNATURES:

COMMITTEE ON INSURANCE:

Prepared by:

Staff Director:

Robert E. Wolfe, Jr.

Stephen Hogge