

**The Florida Senate**  
**PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT**

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

Prepared By: General Government Appropriations Committee

BILL: CS/CS/CS/SB 1894

INTRODUCER: General Government Appropriations Committee, Governmental Operations Committee, Banking and Insurance Committee, and Senator Posey

SUBJECT: Florida Workers' Compensation Joint Underwriting Association

DATE: April 13, 2007                      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	<b>Fav/CS</b>
2.	Wilson	Wilson	GO	<b>Fav/CS</b>
3.	Kynoch	DeLoach	GA	<b>Fav/CS</b>
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

The bill amends laws governing the Florida Workers Compensation Joint Underwriting Association, Inc., (WCJUA) to provide greater accountability and oversight, to assist the WCJUA in achieving tax-exempt status, and to authorize additional funding mechanisms. Some of the provisions are recommendations included in the 2006 Senate Banking and Insurance Committee staff interim report entitled Florida's Workers' Compensation Insurance Rating System.<sup>1</sup> Also, provisions related to the Code of Ethics, financial disclosures, and procurement of goods and services were modeled after legislation enacted last year to provide greater accountability and oversight of Citizens Property Insurance Corporation (Citizens), the property insurer of last resort.<sup>2</sup>

**WCJUA Board Oversight; Tax-Exempt Status**

- The bill revises the WCJUA board appointment process by requiring the Financial Services Commission (FSC) to appoint eight of the nine members instead of three members. The insurance industry will have five representatives, as currently provided by law, however, the FSC will select and appoint each respective representative from a list of five nominees for each vacancy, which would be submitted by the industry. The number of state governmental appointees would remain at four members (including the Consumer Advocate of the Department of Financial Services).

<sup>1</sup> Senate Banking and Insurance Committee Interim Report 2006-101.

<sup>2</sup> Ch. 2006-12, L.O.F.

- Upon dissolution of the WCJUA, the bill requires that all assets of the WCJUA first be used to pay all debts and obligations of the plan and that any remaining assets would revert to the state. This provision will also assist the WCJUA in its effort to obtain tax-exempt status.
- To avoid significant future federal tax liabilities, the bill requires that, on or before January 1, 2008, the WCJUA is required to seek a letter ruling or determination from the IRS regarding the WCJUA's eligibility as a tax-exempt organization. Since its inception in 1994, the WCJUA has incurred an estimated \$33 million in federal income tax expenses, including \$16 million in 2006.

### **Code of Ethics and Financial Disclosure**

- Senior managers, officers, and board members are subject to certain provisions of Part III, ch. 112, F.S., including, but not limited to, standards of conduct, public disclosure requirements, and reporting of financial interests to the Commission on Ethics on an annual basis. Currently, senior managers of state agencies are subject to these provisions. The bill authorizes an employee, director, etc., of an insurance entity to be a board member unless the insurance entity provides certain services to the WCJUA. The bill prohibits such a board member from voting on a matter if the insurance entity would obtain a special benefit that would not apply to similarly situated entities.
- Current and prospective employees are required to submit an annual statement to the WCJUA attesting that no conflict of interest exists.
- Any senior manager or officer of the WCJUA employed as of January 1, 2008, who retires or terminates employment, is prohibited from representing another person before the WCJUA for a two-year period.
- Employees and board members are prohibited from accepting gifts of any value from a person or entity, or an employee or representative of such person or entity, that has a contractual relationship with the plan or who is under consideration for a contract. Employees or board members that fail to comply with this provision are subject to penalties, such as fines. The executive and legislative branches of government are subject to a similar prohibition as that applied to lobbyists.

### **Deficit Funding**

- The WCJUA is required to use any policyholder surplus attributable to former subplan C prior to assessing policyholders in the voluntary market for funding subplan D deficits on a cash flow basis. The surplus in subplan C is approximately \$39 million and the estimated additional funding needed is less than \$5 million.
- The deadline for levying "below-the-line" assessments to fund deficits in subplan D, Tiers One and Two is extended from July 1, 2007, to July 1, 2012.
- The WCJUA is required to return any state funds in excess of the amount necessary to fund deficits in former subplan D or any tier.

### **Regulatory Oversight**

- The WCJUA is required to refund premiums to their policyholders if the Office of Insurance Regulation subsequently disapproves the rate.
- The OIR is required to conduct periodic market conduct examinations of the WCJUA.

- The OIR is authorized to require the WCJUA to withdraw approval of all or part of the plan of operation. Currently, all changes to the plan are subject to approval by the OIR.

### **Procurement of Goods and Services**

- Competitive selection of goods and services valued at over \$25,000 is generally required. Exceptions for exempted services (legal and auditing, etc.), sole sourcing and emergency purchases are authorized. Any purchase that exceeds \$100,000 requires approval by the board of governors. Under current law, state agencies are generally required to procure goods and services valued over \$25,000 through a competitive selection process.
- Guidelines and criteria are provided for determining whether staff attorneys or outside attorneys should be used and factors to be used in selecting outside firms. These procedures are modeled after the guidelines that state agencies use.

This bill substantially amends section 627.311, Florida Statutes.

## **II. Present Situation:**

Prior to the creation of the WCJUA in 1993, the Florida Workers' Compensation Insurance Plan (FWCIP) was the residual market or insurer of last resort for workers' compensation insurance coverage. The FWCIP, administered by the National Council on Compensation Insurance (NCCI), provided workers' compensation insurance to employers who were required by law to maintain coverage and who were unable to purchase such insurance through the voluntary market. Deficits in the FWCIP were funded by assessments on carriers writing such coverage in the voluntary market, based on their market share in the voluntary market.

In 1993, the Legislature eliminated the FWCIP and created the current WCJUA as a nonprofit, self-funded entity, governed by a nine-member board, to act as a residual market.<sup>3</sup> The board is comprised of: three members appointed by the Financial Services Commission (FSC); two members representing the top 20 domestic insurers writing workers' compensation; two members representing the top 20 foreign insurers writing workers' compensation; one member appointed by the largest property and casualty insurance agents' association; and the Consumer Advocate for the Department of Financial Services.

The WCJUA is authorized to establish and use its rates at any time, but no more than two times per calendar year for any rating class. This is commonly referred to as "use and file." This method of rate regulation allows the WCJUA to file its rates and immediately begin using the new rates.

### **2003 WCJUA Legislation**

In 2003 and 2004, the Legislature addressed concerns regarding affordability and availability of workers' compensation insurance for small employers in the WCJUA. In 2003, the Legislature established subplan D in the WCJUA to provide coverage for generally small employers (15 or fewer employees). Although rates in this subplan were capped at 25 percent over the voluntary

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<sup>3</sup> Section 627.311(5), F.S.

market rates, the policies were subject to assessments for additional premiums to cover any deficit in the subplan. At the time, the WCJUA estimated that its premiums for subplan D should have been 2.57 times higher than the voluntary market premium to remain actuarially sound; hence, it projected subplan D would likely incur a deficit. As of December 31, 2003, the WCJUA reported a \$9.9 million deficit.

### **2004 WCJUA Legislation**

In 2004, the Legislature enacted changes to the WCJUA law to address the growing deficit in subplan D and to provide affordable coverage for small employers unable to obtain coverage in the voluntary market.<sup>4</sup> The law provided a one-time appropriation of \$10 million from the Workers' Compensation Administration Trust Fund (WCATF) in the Department of Financial Services to fund any deficit in the WCJUA, which was subsequently vetoed by the Governor. Additionally, the bill authorized the WCJUA to request periodic transfers, not to exceed a total of \$15 million, from the WCATF to cover any remaining subplan D deficit, subject to approval by the Legislative Budget Commission (LBC).

The law also restructured the WCJUA by eliminating subplans A, B, C, and D and creating three tiers with eligibility based on an employer's loss experience, effective July 1, 2004.<sup>5</sup> Premiums in Tier One and Two were capped at 25 percent and 50 percent above the premiums of the voluntary market, respectively, until sufficient experience exists for the WCJUA to establish actuarially sound rates for the tiers, but no earlier than January 1, 2007. On January 1, 2007, rates in Tiers One, Two, and Three were set at 1.34, 2.15, and 2.88 times the voluntary rate, respectively.

Any deficits in Tiers One and Two or any deficit remaining from any of the former subplans can be funded by a "below-the-line" assessment on workers' compensation policies in the voluntary market until July 1, 2007. The WCJUA may request funding through the LBC for any deficit in Tier Three, in the event assessments on Tier Three policyholders are inadequate to fund such a deficit. Former subplan D policyholders are not subject to assessments for the funding of any deficits.

### **Oversight and Regulation of the WCJUA**

The WCJUA, as a residual market mechanism, is exempt from many provisions of the Insurance Code that are applicable to insurers in the voluntary market, such as surplus and solvency requirements. However, the WCJUA and the other residual markets are subject to market conduct examinations pursuant to the OIR's authority under s. 624.3161, F.S., to determine whether the entity is complying with applicable provisions of the Insurance Code and the Workers' Compensation Law. In addition, the WCJUA's plan of operation and any changes to the plan are subject to the approval of the OIR pursuant to s. 627.311, F.S.

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<sup>4</sup> Chapter 2004-266, L.O.F.

<sup>5</sup> Tier One provides coverage for employers that have an experience-rating modification factor of less than 1.0 or, if nonrated, the employers must have a continuous three-year history of workers' compensation coverage and a good loss history. Tier Two provides coverage for new employers, employers with moderate experience, and employers with good experience who do not have a continuous 3-year history of workers' compensation coverage. Tier Three provides coverage for all other employers.

In its *2006 Workers' Compensation Annual Report*, the OIR noted that the capped rates for Tiers One and Two expire on January 1, 2007, after which the rates are required to be actuarially sound. Since the ability to levy below-the-line assessments for Tiers One and Two expires on July 1, 2007, there will be no funding mechanism for deficits in Tiers One and Two after this date. The report notes that this will undoubtedly result in the use of very conservative actuarial assumptions to prevent deficits, which can only mean higher rates.

Due to concerns regarding the accountability of the WCJUA, the Legislature directed the Auditor General to perform an operational audit of the WCJUA.<sup>6</sup> In 2004, the Auditor General released the audit report, which included findings and recommendations regarding the administration, rates, and funding of the WCJUA.<sup>7</sup> The Auditor General's contracted actuary concluded, among other findings, that: required reserves of the WCJUA should be significantly less than the WCJUA actuary's best estimate of required reserves and the WCJUA could have established a lower rate for Tier Three policies. The report recommended that the Legislature consider enacting legislation addressing the use of surplus funds attributable to other subplans, such as subplan C, to fund the deficit in subplan D. Through legislative action, the report noted that it might be possible to reduce the WCJUA's costs by making the WCJUA exempt from federal taxation. The report recommended that the Legislature consider enacting legislation to assist the WCJUA in qualifying as a tax-exempt organization under the Internal Revenue Code. Currently, Citizens and the Florida Automobile Joint Underwriting Association qualify as tax-exempt organizations. For the 2006 calendar year, the WCJUA presently anticipates incurring \$16,590,095 in federal income tax expenses. This would be in addition to the estimated \$16 million in federal income tax expenses that the WCJUA has incurred since its inception in 1994.

### **Funding Deficits in the WCJUA**

On June 30, 2004, the WCJUA ceased writing policies in subplans A, B, C, and D when these subplans were eliminated and Tiers One, Two, and Three were created, effective July 1, 2004. As of January 31, 2007, the WCJUA had 3,026 policies in force.

In the WCJUA's Business Plan Status Report for the first quarter of 2006, the WCJUA initially estimated that it would need the entire \$15 million legislative appropriation to fund deficits attributable to subplan D. To date, the WCJUA has received a total of \$7.9 million of this amount. However, due to positive loss developments, the WCJUA currently estimates a projected total deficit of \$9.3 million attributable to subplan D, thereby only requiring an additional \$1.4 million to fund deficits. However, access to the contingency reserve is eliminated, effective July 1, 2007, by the 2004 legislation.

Without legislative action, the only currently available source of additional funding is the below-the-line assessment. Access to surplus funds in subplan C would apparently require a statutory change. Individual, self-insured employers and governmental self-insurance funds are not subject to the assessment.

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<sup>6</sup> Chapter 2004-266, L.O.F.

<sup>7</sup> Auditor General, State of Florida, *Operational Audit of the Florida Workers' Compensation Joint Underwriting Association, Inc.*, (2004).

The surplus balance in former subplans A, B, and C is approximately \$39 million. Subplans B and C issued assessable policies. The WCJUA states that no policyholder assessments will be required for these subplans.<sup>8</sup> Currently, the operation manual of the WCJUA prohibits the use of surplus funds related to other subplans to fund the subplan D deficit. However, the statutes do not clearly address this issue.

### **Tax-exempt Organizations**

Under section 61 of the Internal Revenue Code, gross income means all income from whatever source derived, except as otherwise provided.<sup>9</sup> Income earned by a state, a political subdivision of a state, or an integral part of a state or political subdivision of a state is generally not taxable in the absence of specific statutory authorization for taxing such income. In cases involving the status of an organization as an instrumentality of the state, the following factors are taken into consideration:<sup>10</sup>

- Whether it is used for a governmental purpose and performs a governmental function.
- Whether performance of its function is on behalf of one or more states or political subdivisions.
- Whether there are any private interests involved or whether the states or political subdivisions involved have the powers and interests of an owner.
- Whether control and supervision is vested in public authority.
- If express or implied authority is necessary for the creation or use of such an instrumentality, and whether such authority exists.
- The degree of financial autonomy and the source of its operating expenses.

In determining whether an entity is an integral part of a state, it is necessary to consider, in addition to factors established in revenue rulings addressing this issue, the totality of the circumstances, including the state's degree of control over the entity and the state's financial commitment to the enterprise, as discussed below.

Presently, a nine-member board, comprised of five members appointed by the insurance industry and four members appointed by state government, governs the WCJUA. Currently, the state does not exercise majority control of the board. In 2004, the Legislature exempted the WCJUA from premium insurance tax and assessments for the Workers' Compensation Administration Trust Fund and the Special Disability Trust Fund. In 2003 and 2004, the Legislature capped the rates in subplan D and Tiers One and Two, respectively. Since 2004, the Legislature has provided approximately \$7.9 million to the WCJUA to fund deficits in subplan D. The WCJUA is subject to the public records and meeting laws of chs. 119 and 286, F.S., as an agency for purposes of ch. 119, F.S. However, the law does not address the distribution of assets of the WCJUA to the state upon dissolution of the WCJUA.

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<sup>8</sup> 2004 Management's Discussion and Analysis, Florida Workers Compensation Joint Underwriting Association filed with the OIR April 1, 2005.

<sup>9</sup> 26 U.S.C. s. 26.

<sup>10</sup> Rev. Rul. 57-128.

Recently, tax consultants engaged by the WCJUA provided written guidance as to the requirements for the WCJUA to be recognized as a tax-exempt entity for federal income taxes.<sup>11</sup> The consultants also recommended legislative changes to allow the state to have control of the board of governors and to require that, upon dissolution of the WCJUA, any remaining assets after payment of liabilities would be distributed to the state. Since its inception in 1994, the WCJUA has incurred \$33 million in federal income tax expenses, including \$16,590,095 for 2006.

### **Senate Banking and Insurance Committee Interim Report Recommendations**

The 2005 interim report provided the following legislative recommendations to address funding, availability, affordability, and accountability issues relating to the WCJUA:

- Authorize the WCJUA to use some of the estimated \$15 million surplus funds attributable to former subplan C to mitigate the estimated \$4.77 million deficit in subplan D and any deficits in Tiers One and Two that are a result of the capped rates. The capped rates in Tiers One and Two are eliminated by January 1, 2007.
- Exclude former policyholders of subplan C from any potential assessments to prevent these former policyholders from incurring any potential liability in the event that the WCJUA's estimated surplus in these plans adversely changes.
- Require the WCJUA to return any unused state funds allocated for funding subplan D deficit to the state.
- Consider enacting legislation to assist the WCJUA in meeting criteria to qualify as a tax-exempt organization under s. 501(c) of the Internal Revenue Code, such as changing the board composition of the WCJUA so that the state appoints a majority of the board members.

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

**Section 1** amends s. 627.311, F.S., by revising the appointment process for selecting members on the board of the WCJUA. The section requires the FSC to appoint all members, except for the Consumer Advocate who is appointed by the Department of Financial Services, rather than only three members. The representation by the remaining members is unchanged by the bill: two representatives of the top twenty domestic workers' compensation insurers, two representatives of the top twenty foreign workers' compensation insurers, and one person representing the largest property and casualty agents' association in Florida. However, the Financial Services Commission (FSC) would select and appoint the respective insurance industry representatives from a list of five names submitted for each vacancy by the industry segment represented by the board vacancy. Currently, such vacancies are filled by the representative companies electing a member to the board. The number of state governmental appointees would remain at four members (three members appointed by the FSC and the Consumer Advocate). This would assist the WCJUA in achieving its tax-exempt status. All board members would serve at the pleasure of the FSC.

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<sup>11</sup> Correspondence from Thomas Howell Ferguson P.A. to Laura Torrence, Executive Director of the WCJUA, dated February 14, 2006.

This section of the bill provides technical, clarifying changes related to public records and meetings of the WCJUA. This section provides that the records and meetings of the board of governors and the plan be subject to ch. 286, F.S., as well as ch. 119, F.S., unless otherwise provided by law. Under ch. 119, F.S., minutes, audits, and procedures are subject to the public records law, unless specifically exempted. Presently, the WCJUA does not have any specific public record or public meeting exemption in its governing laws. Therefore, all of these records and meetings will be subject to chs. 119 and 286, F.S., unless otherwise provided by these statutes. Chapter 286, F.S., provides that all meetings and minutes of such meetings of any board or commission or any agency or authority of the state are open to the public, except as otherwise provided by law.

This section also authorizes the OIR to withdraw approval of all or part of the plan of operation if the OIR determines that conditions warrant such action. Currently, any changes to the plan of operation are subject to approval of the OIR. This change strengthens the OIR's oversight of WCJUA operations and appears to codify current practice of the OIR. Citizens is also subject to this type of oversight.

The following procedures and guidelines for the procurement of goods and services are specified in the bill, which are also required of Citizens:

- Generally, the bill requires competitive selection of goods and services valued at over \$25,000. Exceptions for exempted services (legal and auditing, etc.), sole sourcing, and emergency purchases are authorized. Any purchase that exceeds \$100,000 requires approval by the board of governors. Under current law, state agencies are generally required to procure goods and services valued over \$25,000 through competitive selection. Purchases valued at or below \$25,000 must be secured through written or verbal quotes or informal bids, whenever practical.
- The bill provides guidelines and criteria for determining whether the WCJUA should engage staff attorneys or outside attorneys and delineates factors for selecting outside firms. This language is modeled after the guidelines state agencies use pursuant to ch. 287, F.S.

The bill provides the following requirements related to standards of conduct and financial disclosure, which are also currently required of Citizens:

- Senior managers, officers, and board members are subject to Part III, ch. 112, F.S., including, but not limited to, standards of conduct, public disclosure requirements, and reporting of financial interests to the Commission on Ethics and the OIR on an annual basis. The bill also allows an employee, director, etc., of an insurance entity to be a board member unless such an entity or its affiliate provides policy issuance, policy administration, underwriting, claims handling, or payroll audit services to the plan. A board member who is employee, director, etc., of an insurance entity may not participate in or vote on a matter if the insurance agency, insurance company, or other insurance entity would obtain a special or unique benefit that would not apply to other similarly situated insurance entities.
- Current and prospective employees are required to submit an annual statement to the WCJUA attesting that no conflict of interest exists.

- Any senior manager or officer employed on January 1, 2008, regardless of the original date of hire, who retires or terminates from the WCJUA, is prohibited from representing another person before the WCJUA for a two-year period.
- Employees and board members are prohibited from accepting gifts or expenditures of any value from a person or entity, or from an employee or representative of such person or entity, that has a contractual relationship with the plan or who is under consideration for a contract. Employees or board members that fail to comply with this provision are subject to penalties, such as fines.

The WCJUA is required to fund any deficits in subplan D, Tier One, or Tier Two by using policyholder surplus attributable to former subplan C or, if the surplus in subplan C does not fully fund the deficit, the WCJUA may assess the voluntary market policyholders. Currently, the funding mechanism for subplan D is the contingency reserve first, then assessments on policyholders in the voluntary market, if the contingency reserve cannot fully fund the deficit. This section extends the provision in current law for funding deficits in Tiers One and Two through assessments on policyholders in the voluntary market, from July 1, 2007, to July 1, 2012. Entities that were policyholders in former subplan C are not subject to any assessments.

Funding for Tier Three deficits will continue to be initially provided through assessments on policyholders in Tier Three. The WCJUA can continue to request funding for any remaining deficit from the Workers Compensation Administration Trust Fund, subject to the approval of the LBC. The LBC will evaluate such requests for funds based on the cash flow needs of the WCJUA on a six-month basis, rather than the current three-month basis. This section requires the WCJUA to return any state funds in excess of the amount necessary to fund a deficit in subplan D or any tier.

The bill revises the ratemaking process for the WCJUA by requiring the WCJUA to refund premiums to their policyholders if the Office of Insurance Regulation subsequently disapproves the rate implemented by the WCJUA.

The section transfers two general provisions relating to plans and associations, including the WCJUA, to two new subsections to provide greater clarity.

**Section 4** requires that, on or before January 1, 2008, the WCJUA must seek a letter ruling or determination from the IRS as to the WCJUA's eligibility as a tax-exempt organization. Since its inception in 1994, the WCJUA has incurred an estimated \$33 million in federal income tax expenses.

**Section 5** provides that this act shall take effect July 1, 2007, except as otherwise provided.

#### **IV. Constitutional Issues:**

##### **A. Municipality/County Mandates Restrictions:**

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

**V. Economic Impact and Fiscal Note:**

A. Tax/Fee Issues:

Without legislative action to provide additional contingency funding beyond July 1, 2007, or authorization for the WCJUA to access some of its \$39 million surplus, the WCJUA may find it necessary to levy a “below-the-line” assessment on policyholders in the voluntary market to fund the estimated \$1.4 million deficit attributable to the former subplan D. Individual, self-insured employers and governmental self-insurance funds are not subject to the assessment. Contingent upon the future financial condition of the WCJUA, the receipt of state funds could generate additional federal income tax liability for the WCJUA, thereby reducing the ultimate value of such state funds provided to the WCJUA.

Once legislative changes related to the organization and operations of the WCJUA are enacted and the WCJUA is able to receive a tax ruling or determination from the IRS that it qualifies as a tax-exempt organization, the WCJUA would be eligible to be exempt from federal income tax as a tax exempt entity. Since 1994, the WCJUA has incurred \$33 million in federal income tax expenses, including \$16 million in 2006. Reductions in such administrative costs could result in reduced rates for policyholders, since federal income taxes totaled 31 percent of the WCJUA’s gross earned premium in 2006.

B. Private Sector Impact:

Policyholders in the WCJUA may benefit from the change in ratemaking process, since the WCJUA will be required to retrospectively refund premiums if the OIR determines that the implemented rates were excessive.

C. Government Sector Impact:

The bill eliminates the WCJUA’s ability to access the contingency reserve for former subplan D and Tiers One and Two established by the state and requires the WCJUA to use some of the estimated \$39 million of policyholder surplus attributable to former subplan C. In the event the surplus in subplan C is inadequate to fund the estimated \$2 million deficit attributable to former subplan D, the bill extends the WCJUA’s ability to assess the voluntary market for an additional 5 years, from July 1, 2007, to July 1, 2012.

The WCJUA will incur fees associated with obtaining an Internal Revenue Service (IRS) tax-exempt determination. The IRS imposes user fees for the consideration and issuance of letter rulings on the determination of tax liability.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

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This Senate Professional Staff Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

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## **VIII. Summary of Amendments:**

None.

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