

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 1011 Warranty Associations
SPONSOR(S): Insurance & Banking Subcommittee and Abruzzo
TIED BILLS: **IDEN./SIM. BILLS:** SB 1262

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	14 Y, 0 N, As CS	Cooper	Cooper
2) Government Operations Appropriations Subcommittee		Keith	Topp
3) Economic Affairs Committee			

SUMMARY ANALYSIS

Chapter 634, F.S., governs the regulation of warranty associations, which are motor vehicle service agreement companies, home warranty associations and service warranty associations. Motor vehicle service agreements provide vehicle owners with protection when the manufacturer's warranty expires. Home warranty associations indemnify warranty holders against the cost of repairs or replacement of any structural component or appliance in a home. Service warranty contracts for consumer electronics and appliances allow consumers to extend the product protection beyond the manufacturer's warranty terms.

Although a warranty is not considered a traditional insurance product, it protects purchasers from future risks and associated costs. In Florida, warranty associations are regulated by the Office of Insurance Regulation (OIR). The OIR's regulatory authority includes approval of forms, investigation of complaints, and monitoring of reserve requirements, among other duties. However, OIR is not required to approve rates for warranties.

Under current law, warranties offered by the three types of warranty associations are cancelable by the purchaser who is entitled to a refund. For motor vehicle service agreements, refunds may be effectuated through the automobile dealer that originally sold the service agreement to the customer, although the service agreement company still remains responsible for the full refund. For home and service warranties, refunds are made by the respective associations.

The bill maintains the authority for automobile dealers to effectuate the refunds but codifies some of the documentation regarding refunds currently required by OIR. For home warranty and service warranty products, the bill specifies that the associations may provide refunds through the issuing sales representatives. Specific to service warranty associations, the bill permits refunds to be made by cash, check, store credit, gift card, or other similar means, but requires refunds by check if requested by the customer.

Currently, OIR is required to conduct periodic examinations regarding the financial and market conduct affairs of warranty associations. The bill eliminates this requirement, but authorizes OIR to examine them at its discretion. The bill continues to allow OIR to use independent examiners and levy the companies for the costs of their services, but limits those costs to no more than ten percent of the companies prior year reported income.

The bill authorizes entities to provide donations and grants to the Department of Financial Services to pursue unauthorized entities operating in violation of the statutory provisions relating to warranty associations. Also, the bill restores motor vehicle service agreement coverage for motor vehicles used for commercial purpose unless those vehicles have a gross weight rating of 10,000 pounds or more.

The bill will have an insignificant fiscal impact on the Office of Insurance Regulation. By removing the required OIR examinations, some associations will no longer have to pay a \$2,000 filing fee when seeking an examination exemption. OIR indicates that there are currently 15 entities that filed for the exemption. The provisions of CS/HB 1011 will result in a recurring loss of approximately \$30,000 in revenue to be deposited into the Insurance Regulatory Trust Fund.

The bill takes effect on July 1, 2012.

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

STORAGE NAME: h1011b.GOAS

DATE: 2/9/2012

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Chapter 634, F.S., governs the regulation of warranty associations, which are motor vehicle service agreement companies, home warranty associations and service warranty associations. Motor vehicle service agreements provide vehicle owners with protection when the manufacturer's warranty expires. Home warranty associations indemnify warranty holders against the cost of repairs or replacement of any structural component or appliance in a home. Service warranty contracts for consumer electronics and appliances allow consumers to extend the product protection beyond the manufacturer's warranty terms.

While a warranty is not considered a traditional insurance product, it protects purchasers from future risks and associated costs. In Florida, warranty associations are regulated by the Office of Insurance Regulation (OIR). The OIR's regulatory authority of warranty associations includes approval of forms, investigation of complaints, and monitoring of reserve requirements, among other duties. However, OIR is not required to approve rates for warranties.

Motor Vehicle Service Agreements

Under current law, a motor vehicle service agreement indemnifies the vehicle owner (or holder of the agreement) against loss caused by failure of any mechanical or other component part, or any mechanical or other component part that does not function as it was originally intended. It also includes agreements that provide for: the coverage or protection which is issued or provided in conjunction with an additive product applied to the motor vehicle; payment of vehicle protection expenses; and, the payment for paintless dent-removal services.¹ Exempt from this definition (and therefore exempt from regulation under the Florida Insurance Code) are service agreements that are sold to persons other than consumers and that cover motor vehicles used for commercial purposes.

To offer motor vehicle service agreements in Florida one must be licensed and pay an annual nonrefundable license fee to OIR. All applicants for licensure must meet certain solvency requirements and, once licensed, must report to OIR certain financial and statistical information on a quarterly basis. Companies are also required to file with the office the rates, rating schedules, or rating manuals used, including all modifications of rates and premiums, to be paid by the service agreement holder. The office does not have authority to approve rates but they are required to review and approve forms used in the state.²

Cancellation of Service Agreements

The bill makes several changes in the regulatory framework of motor vehicle service agreements, including cancellation provisions. Currently, any service agreement is cancelable by the purchaser within 60 days after purchase. The individual is also entitled to a refund which must be 100 percent of the gross premium paid, less any claims paid on the agreement. A reasonable administrative fee may be charged, not to exceed 5 percent of the gross premium paid by the agreement holder. After the service agreement has been in effect for 60 days, it may not be canceled by the insurer or service agreement company unless:

- 1) there has been a material misrepresentation or fraud at the time of sale of the service agreement;
- 2) the agreement holder has failed to maintain the motor vehicle as prescribed by the manufacturer;
- 3) the odometer has been tampered with or disabled and the agreement holder has failed to repair the odometer; or

¹ s.634.011(8), F.S.

² ss. 634.011-634.289, F.S.

- 4) for nonpayment of premium by the agreement holder.³

Additionally, current law states that if the service agreement is canceled by the insurer or service agreement company, the return of premium must not be less than 100 percent of the paid unearned pro rata premium, less any claims paid on the agreement. Current law also provides that if, after 60 days, the service agreement is canceled by the service agreement holder, the insurer or service agreement company must return directly to the agreement holder not less than 90 percent of the unearned pro rata premium and may also deduct from the refund the amount of any claims paid on the agreement. Under current law, the service agreement company remains responsible for full refunds to the consumer on canceled service agreements. However, the salesperson and agent are responsible for the refund of the unearned pro rata commission. A service agreement company may effectuate refunds through the issuing salesperson or agent.⁴

The bill provides that if the service agreement company effectuates refunds through the issuing salesperson or agent, the service agreement company must send the unearned pro rata premium refund due, less any unearned pro rata commission, to the salesperson or agent effectuating the refund. Upon receipt, the salesperson or agent must refund the unearned pro rata premium, including any unearned pro rata commission, and the sales tax refund owed to the service agreement holder.

The bill requires the salesperson or agent to maintain copies of certain documents to demonstrate that the refund has occurred and shall provide those copies to the service agreement company within 45 days after a request is made by the department or OIR.⁵ If OIR finds that a salesperson or agent exhibits a pattern or practice of failing to properly provide refunds or fails to maintain or remit the specified documentation, the office must then notify the Department of Financial Service (DFS).

Another change in the bill is the restoration of motor vehicle service agreement coverage for certain vehicles used for commercial purposes. The bill eliminates the current exemption from the definition of motor service agreement for such vehicles, however, it would only apply to vehicles having a gross weight rating of less than 10,000 pounds. Vehicles over that weight will continue to not be covered because they do not meet the current definition of a motor vehicle. Thus, with the changes made by the bill, small business owners should once again receive all of the protections now provided to individual consumers.

Examination of Companies

Currently, OIR may periodically examine motor vehicle service agreement companies in the same manner and subject to the same terms and conditions as applies to insurers under part II of chapter 624. Consequently, the office may examine each insurer as often as may be warranted for the protection of the policyholders and in the public interest, but must examine each company not less frequently than once every 5 years.⁶ Criteria are provided in statute for OIR to consider in determining whether to conduct examinations. Also, rules are authorized, but not required, to establish provisions for exemptions from examination.

Current law also provides that the examinations may be conducted by independent certified public accountants, actuaries, investment specialists, information technology specialists, and reinsurance specialists with the costs paid for by the companies.⁷ A similar provision exists for market conduct examinations.⁸

³ s. 634.121(3)(b), F.S.

⁴ s. 634.121, F.S.

⁵ The required documentation is based, in part, on guidance provided by OIR in *Informational Memorandum, OIR-11-04M*, issued April 11, 2011.

⁶ s. 634.141, F.S. and s. 624.316, F.S.

⁷ s. 624.316, F.S.

⁸ s. 624.3161, F.S.

The bill makes several changes regarding examinations. It maintains the option to use independent examiners but limits those costs to no more than ten percent of the companies prior year reported income. The bill also specifies that OIR is not required to conduct periodic examinations, but may examine a service agreement company at its discretion. Criteria for OIR to use in determining whether to use that discretion are eliminated. It also states that an examination may cover a period of only the most recent 5 years.

Gifts and Grants to Combat Unauthorized Entities

In 2011, the Legislature created s. 626.9894, F.S., which authorizes DFS to accept, for purposes of anti-fraud efforts, any donation or grant of property or moneys from any governmental unit, public agency, institution, person, firm, or corporation. Any such gift or grant is immediately vested in the Division of Insurance Fraud and deposited into the Insurance Regulatory Trust Fund. Donations are separately accounted for and may be used by the division to carry out its duties and responsibilities, or for the subgranting of such funds to state attorneys for the purpose of funding or defraying the costs of dedicated fraud prosecutors. The law also provides that moneys deposited into the Insurance Regulatory Trust Fund may be appropriated by the Legislature for the purpose of enabling the division to carry out its duties and responsibilities, or for the purpose of funding or defraying the costs of dedicated fraud prosecutors.

The bill creates new authority for a governmental unit, public agency, institution, person, firm, or legal entity to provide money to DFS to enable the department to pursue unauthorized entities operating in violation of provisions relating to motor vehicle service agreement companies. The department is also authorized to transfer funds to OIR to take enforcement action against unauthorized entities. Similar to s. 626.9894, F.S., the bill provides that moneys deposited into the Insurance Regulatory Trust Fund may be appropriated by the Legislature for the purpose of enabling the division to carry out its duties and responsibilities, or for the purpose of funding or defraying the costs of dedicated fraud prosecutors.

Home Warranty Associations

Home warranty associations are organizations, other than authorized insurers, that issue home warranties. A home warranty is a contract or agreement whereby a person undertakes to indemnify the warranty holder against the cost of repair or replacement, or actually furnishes repair or replacement, of any structural component or appliance of a home, necessitated by wear and tear or an inherent defect of any such structural component or appliance or necessitated by the failure of an inspection to detect the likelihood of any such loss.⁹

The regulatory framework of home warranty associations is similar to the oversight of motor vehicle service agreement companies. Regarding cancellations, any home warranty agreement may be canceled by the purchaser within 10 days after purchase. The refund must be 100 percent of the gross premium paid, less any claims paid on the agreement. A reasonable administrative fee may be charged, not to exceed 5 percent of the gross premium paid by the warranty agreement holder. After the home warranty agreement has been in effect for 10 days, if the contract is canceled by the warranty holder, a return of premium must be based upon 90 percent of unearned pro rata premium less any claims that have been paid. If the contract is canceled by the association for any reason other than for fraud or misrepresentation, a return of premium must be based upon 100 percent of unearned pro rata premium, less any claims paid on the agreement.¹⁰

Unlike the current law for motor vehicle service agreements which allow refunds by the issuing salesperson or agent, the current law for home warranty associations does not explicitly authorize that practice. The bill does, by stating that an association may effectuate a refund through the issuing sales representative. However, unlike the changes for motor vehicle service agreements, the bill does not provide detail or require documentation for home warranty associations regarding the effectuation of their refunds.

⁹ s. 634.301, F.S.

¹⁰ s. 634.312, F.S.

Regarding examinations of home warranty associations by OIR, the bill makes the same changes made for motor vehicle service agreements. The only difference is that currently there is no examination exemption process for home warranty associations as there is for motor vehicle service agreements. Hence, there is no rule authorization to repeal.

Also, the bill creates the same process for donating money to DFS to pursue unauthorized entities providing home warranties as provided for motor vehicle service agreement companies.

Service Warranty Associations

Service warranty associations are entities, other than insurers, which issue service warranties. A service warranty is an agreement or maintenance service contract equal to or greater than 1 year in length to repair, replace, or maintain a consumer product, or for indemnification¹¹ for repair, replacement, or maintenance, for operational or structural failure due to a defect in materials or workmanship, normal wear and tear, power surge, or accidental damage from handling in return for the payment of a segregated charge by the consumer.¹²

As with the other two types of warranty associations, service warranty entities must meet certain regulatory requirements to offer their products in Florida. Regarding cancellations, current law provides that each service warranty contract shall contain a cancellation provision. If the contract is canceled by the warranty holder, return of premium must be based upon no less than 90 percent of unearned pro rata premium less any claims that have been paid or less the cost of repairs made on behalf of the warranty holder. If the contract is canceled by the association, return of premium must be based upon 100 percent of unearned pro rata premium, less any claims paid or the cost of repairs made on behalf of the warranty holder.¹³

Like the provision in the bill for home warranty associations, service warranty associations may effectuate refunds through the issuing sales representative. No additional detail or documentation is provided. A provision is added to current law regarding the form of a refund (which now is apparently cash or check). The bill provides that a refund owed to a warranty holder may be in the form of cash, check, store credit, gift card, or other similar means. However, upon request of the service warranty holder the refunds must be remitted by check.

The examination provisions in the bill are the same as with the other two warranty associations. For service warranty associations, current language specific to the rate charged for service warranty providers is deleted, as well as a filing fee of \$2,000 which accompanies Form 10-K as filed with the United States Securities and Exchange Commission. Currently, companies may file the Form 10-K with the office to have the examination requirement waived or, at the very least, the costs associated with their examinations, adjusted. However, to utilize this option the associations must pay a filing fee of \$2,000 with Form 10-K. Because OIR is not required to examine these companies on a regularly scheduled basis, but rather on an as needed one, businesses that sell service warranties should experience cost savings.

Finally, the bill authorizes entities to provide money to DFS to enable the department to pursue unauthorized parties operating in violation with the provisions relating to service warranty associations in the same manner as the bill did for the other two warranty associations.

¹¹ Pursuant to s. 634.401 (5), F.S., "Indemnify" means to undertake repair or replacement of a consumer product, or pay compensation for such repair or replacement by cash, check, store credit, gift card, or other similar means, in return for the payment of a segregated premium, when such consumer product suffers operational failure.

¹² s. 634.401(13), F.S.

¹³ s. 634.414, F.S.

B. SECTION DIRECTORY:

Section 1: Amends s. 634.011, F.S., relating to definitions.

Section 2: Amends s. 634.121, F. S., relating to forms, required procedures, and provisions.

Section 3: Amends s. 634.141, F.S., relating to examination of motor vehicle service agreement companies.

Section 4: Creates s. 634.2855, F.S., relating to unauthorized entities; gifts and grants.

Section 5: Amends s. 634.312, F. S., relating to forms, required provisions, and procedures for home warranty associations.

Section 6: Amends s. 634.314, F. S., relating to examination of home warranty associations.

Section 7: Creates s. 634.3385, F.S., relating to unauthorized entities; gifts and grants.

Section 8: Amends s. 634.414, F. S., relating to forms; required provisions, for service warranty associations.

Section 9: Amends s. 634.416, F. S., relating to examination of service warranty associations.

Section 10: Creates s. 634.4385, F.S., relating to unauthorized entities; gifts and grants.

Section 11: Provides an effective date of July 1, 2012.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The bill will have an insignificant fiscal impact on the Office of Insurance Regulation. OIR indicates that the provisions of CS/HB 1011 will result in a recurring loss of approximately \$30,000 in revenue to be deposited into the Insurance Regulatory Trust Fund¹⁴.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

¹⁴ E-mail correspondence from OIR to House Appropriations Staff, February 3, 2012, on file with the House Government Operations Appropriations Staff.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Because regularly scheduled examinations by OIR will no longer be required for warranty associations, companies will save costs associated with preparing for and actually undergoing those examinations. Also, companies will no longer, on a regular basis, have to pay for OIR's costs associated with the examinations. Entities that currently apply for examination exemptions will experience a cost reduction of a \$2,000 filing fee.

D. FISCAL COMMENTS:

The bill will have an insignificant fiscal impact on the Office of Insurance Regulation. By removing the required OIR examinations, some associations will no longer have to pay a \$2,000 filing fee when seeking an examination exemption. OIR indicates that the loss of fees from the 15 entities that filed for the exemption will result in a recurring loss of approximately \$30,000 in revenue to be deposited into the Insurance Regulatory Trust Fund.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

B. RULE-MAKING AUTHORITY:

The bill removes rulemaking authority for the Financial Services Commission to establish provisions whereby motor vehicle service agreement companies may be exempt from examinations by OIR.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On January 17, 2012, the Insurance & Banking Subcommittee unanimously adopted one strike-all amendment to HB 1011 which retained many of the same provisions of the bill as filed and made the following major changes:

- Deleted the provision in current law that provides service agreements that are sold to persons other than consumers and that cover motor vehicles used for commercial purposes are excluded from the definition of motor vehicle service agreement and are exempt from regulation under the Florida Insurance Code.
- Clarified the provisions in the bill which authorize donating money to DFS for the purpose of pursuing unauthorized entities that violate the laws regarding warranty associations.
- Restored current law which the bill removes regarding OIR's use of independent examiners. However, the costs associated with the use of those examiners are capped.
- Made technical changes to correct drafting errors.

This analysis is drafted to the committee substitute as passed by the Insurance & Banking Subcommittee.