

# FLORIDA SPECIAL DISABILITY TRUST FUND ASSESSMENTS

## WHAT IS PREMIUM ANYWAY?

Kevin G. Fitzgerald, Esq.<sup>1</sup>  
(414) 297-5841  
(850) 222-6100

Premium – it seems like a simple enough concept. Premium is, well, premium. But when you start looking at the possible “definitions” of premium, it is easy to get confused. There is direct premium, gross written premium, net written premium, earned premium, collected premium, reinsurance ceded premium, reinsurance assumed premium; and in workers compensation, there is manual premium, standard premium, modified premium, etc. Given this morass, it is easy to see how the Florida legislature could choose a term, which absent an explicit statutory definition, is at best ambiguous.

### *Background*

Florida assesses workers’ compensation carriers doing business in the state (“Carriers”) to support two funds: (1) a Special Disability Trust Fund (the “SDTF”), which is a fund created to encourage employers to hire individuals with preexisting physical impairments by spreading the increased risk of workers’ compensation losses and costs associated with such employment;<sup>2</sup> and (2) an administration fund (the “Administration Fund”), which is a fund established to cover the costs of administration of Florida’s Workers’ Compensation Law (“W/C Law”) by the Florida Department of Labor and Employment Security (“DOLES”), Division of Workers’ Compensation (“DWC”).<sup>3</sup>

The assessments for the SDTF and the Administration Fund appear to be calculated on a slightly different premium basis. On the one hand, the SDTF assessment is calculated as a percentage of a Carrier’s “*net premiums written*” in Florida, not to exceed 4.52%.<sup>4</sup> On the other hand, the Administration Fund assessment is calculated as a percentage of a Carrier’s “*net premiums collected*” in Florida, not to exceed 4%.<sup>5</sup> Further, a Carrier can deduct any amounts paid for the Administration Fund assessment from the amount of any other tax levied in Florida on the Carrier’s “premiums, assessments, or deposits for workers’ compensation insurance on contracts or policies.”<sup>6</sup> However, there is no similar deduction allowed for SDTF assessments.

### *The Issue: What Is Net Premiums Written?*

The W/C Law does not define the term “net premiums written” as it is used in Section 440.49. However, it is evident that the term means something other than “gross premiums,” as prior to a 1975 amendment the calculation of the SDTF assessment was based on a percentage of “gross premiums.” *See*, 1975 Fla. Laws ch. 75-209 (substituted the term “net premiums” for “gross premiums” in the subsection of Section 440.49 then relating to the SDTF assessment).<sup>8</sup> Unfortunately, the W/C Law also fails to define the term “gross premiums.”

Despite the lack of any definition in the W/C Law, the Florida Insurance Code (“Code”) provides some insight into the meaning of the term “net premiums written.” Although the Code provides no general definition of the term, in a statute relating to the calculation of gross underwriting profit for wet marine and transportation insurance, it provides:

Such gross underwriting profit shall be ascertained by deducting from the *net premiums (i.e., gross premiums less all return premiums and premiums for reinsurance)* on such wet marine and transportation insurance contracts the net losses paid (i.e. gross losses paid less salvage and recoveries on reinsurance ceded) during such calendar year under such contracts.<sup>9</sup>

Perhaps more importantly, the term “net written premiums” is defined in the NAIC Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies (“Manual”)<sup>10</sup> as:

[t]he net written premiums of an insurance company are equal to the direct premiums, plus the reinsurance assumed premiums, less the reinsurance ceded premiums.<sup>11</sup>

Thus, it is logical to interpret “net premiums written,” as that term is used in Section 440.49, to mean direct premiums written plus or minus any premiums for reinsurance assumed or ceded.

The issue in dispute, therefore, is whether to use gross written premium less returns and cancellations as the definition of net premiums written or whether it is more appropriate to use the NAIC definition which is direct written premium less reinsurance premium ceded plus reinsurance premiums assumed. Obviously, these two premium bases can be significantly different, especially for a direct writing insurance company that purchases a significant amount of reinsurance protection.

Use of the NAIC definition is arguably supported by the Florida legislature (“Legislature”) which specifically refers to instances when insurers are not allowed to deduct reinsurance ceded premiums in calculating various assessments. Examples of this include:

1. Section 624.509, related to calculation of premium taxes. When insurers make the calculation of premium tax, they are required to do so, “without deductions: (1) For reinsurance ceded to other insurers . . .”<sup>12</sup>
2. Section 63 1.54(8), related to the Florida Guaranty Association (“Association”). This section creates the defined term “net direct written premiums,” which is used as a basis for Association assessments. It defines the term as “direct gross premiums written in [Florida] . . . , less return premiums thereon and dividends paid or credited to policyholders on such direct business. ‘Net direct written premiums’ *does not include premiums on contracts between insurers or reinsurers.*”<sup>13</sup>

Accordingly, it is evident that the Legislature was cognizant of reinsurance premiums and sought to specifically exclude their deduction when insurers calculate premium taxes and assessments due to the Association. Thus, the failure to specifically define “net premiums written” in Section 440.49 and/or specifically preclude Carriers from deducting reinsurance ceded premiums in the calculation can be construed as evidence that the Legislature did not intend to preclude Carriers from making such a deduction.

Nonetheless, there may be an alternative argument that “net premiums written” has a unique meaning in the workers’ compensation context. This argument is based on Rule 4-190.66(4) which provides:

In determining “net premiums” on which Administrative and Special Disability Assessments are computed pursuant to Sections 440.49(2)(h) and 440.5 1, Florida Statutes, self-insurer funds shall use amounts collected after both advance discounts and refunds. In no event shall the fund be allowed to deduct more than 15 percent from standard premium when calculating net premium.<sup>14</sup>

Based on this, an argument can be forwarded that it makes no sense to cap the deduction available to self-insurers in calculating “net premiums,” without imposing a similar cap on Carriers. Of course, the rejoinder to this argument is that if the drafters of this portion of the Florida Administrative Code meant for a similar cap on the deductions Carriers use in computing “net premiums,” the drafters were capable of drafting a provision doing so and, indeed, should have done so expressly. Further, a look at the nature of self-insurers funds (“SIFs”) and the differences in regulation between SIFs and Carriers explains the rule. Specifically, SIFs normally cover their risk by purchasing workers’ compensation aggregate excess policies, as opposed to traditional reinsurance. These policies, while similar to reinsurance in many ways, were not considered by the Florida Department of Insurance to be reinsurance for many purposes.

The DWC apparently concurred initially in reading the phrase “net premiums written” to mean direct premium less reinsurance ceded premium. In a September 29 memo, Senior Attorney Nancy Staff Slayden of the DWC stated: “At some point, the division began interpreting the definition of ‘net premiums written’ and ‘net premiums collected’ to mean the ‘net of premiums ceded to reinsurers.’”<sup>15</sup> Paul Wotherspoon, senior management analyst in the DWC Bureau of Operations Support, also stated: “Most insurance companies report honestly to us: 60-70 percent report direct written premium. They don’t take any discounts or other stuff. They just report to us what they write. So I guess in a sense, they’re over-reporting.”<sup>16</sup>

In fact, several insurance carriers concluded that they were over-reporting and, as of January 3, 2000, at least ten insurers have filed requests for refunds in excess of \$66 million relating to assessment overpayments.<sup>17</sup> Thus, the amount at stake for the State of Florida, and in particular these two trust funds, is quite significant.

### *Florida's Response*

**1999 Legislative Session.** In the 1999 legislative session, DOLES attempted, in both the House and the Senate, to pass legislation that would, among other things, resolve the question of the assessment base. The language proposed defined net premiums written to mean direct written premium less returns and cancellations without deduction for any reinsurance ceded or additions for reinsurance assumed. In other words, the proposed legislation attempted to choose what is by some estimates the higher premium base for calculating the assessment. Both of these bills failed to make it through the House and Senate, and accordingly no change was effected by the Legislature in 1999.

**DOLES Bulletin.** Perhaps in response to the failure to resolve these issues in the 1999 Legislative Session, on September 22, 1999, DOLES issued "Bulletin # - 209" setting out its position with regard to the definitions of the terms "net premiums written" and "net premiums collected" for the purpose of determining the premium base from which assessments are paid to the SDTF and the Administration Fund. The Bulletin provides:

Pursuant to s. 440.49, Florida Statutes, the Division of Workers' Compensation is collecting assessments for the Special Disability Trust Fund based on net written premium, which the Division is interpreting to mean all premiums written less return premiums arising from policies issued by an insurer.<sup>18</sup>

While the Division's "interpretation" is less ambiguous than the statutory language it is interpreting, the Division's own bulletin adds ambiguity by then interpreting "net premiums collected" for purposes of the Administration Fund as follows:

Net premium collected is being interpreted by the Division to mean all premiums, including those ceded to reinsurers, minus applicable discounts provided by law.<sup>19</sup>

Why the Division made reference to premiums ceded to reinsurers when "interpreting" net premium collected, but remained silent on reinsurance premiums ceded when "interpreting" net written premium, is not clear from the Bulletin.

**2000 Legislative Session.** This topic will be revisited again this coming legislative session, commencing March 7, 2000. Recent meetings of the committees of both the Florida House and Senate having jurisdiction over insurance have included discussions of proposed legislation potentially impacting Florida's workers' compensation system and insurers writing workers' compensation coverage in Florida. Representative Bainter, Chairman of the House Insurance Committee, indicated during the Committee's January 18 meeting that the issue remains in the Governor's office and the Committee is waiting for their recommendation on the overall issue of funding for the workers' compensation administrative and special disability trust funds.

In addition to the assessments issue discussed herein, deregulation of workers' compensation rates and forms is also very much on the minds of lawmakers for the 2000 regular session.

- i. Assessments. The assessment issue remains one of paramount concern to DOLES, as it has already resumed advancing its position at the Capitol. The staff of the House Insurance Committee has already prepared an update relating to funding of the Administrative Fund and the SDTF. The update, which was prepared in concert with DOLES, focuses upon the dangers faced by DOLES and the trust funds due to a declining premium base and issues of "underpayment" relating to calculation of the assessments. As in the 1999 regular session, DOLES will in 2000 likely seek legislation that will "clarify" the law to include in the assessment base premium ceded to reinsurers.
- ii. Rate and Form Deregulation. The deregulation of workers' compensation rates and forms being considered by the Legislature may not have the immediate impact of any action taken on the assessment issue, but it has the potential to significantly alter Florida's competitive landscape. Such

deregulation has been studied and discussed by Department of Insurance and the Legislature for several years, and appears to be gaining momentum.

Draft legislation on the issue of deregulation provides for two basic changes. First, insurers are exempted from the rate and form approval requirements for policies issued to large commercial risks. It is important to note that while workers' compensation and employer's liability insurance are currently excepted from the change, the Committee is focusing on the legislation's potential benefit with regard to workers' compensation costs and an amendment to include that coverage is surely on the horizon.

The second change alters the excess rating statute to permit insurers not only to charge rates in excess of their filed rates under certain circumstances, but also to charge rates less than those filed and approved for up to 10 percent of an insurer's book of business. If this legislation is brought forward, it would permit individual downward rate deviations and significantly increase price competition, particularly with regard to larger employers.

### *Conclusion*

Thus, until the Legislature acts to clarify the situation, there remains a significant discrepancy between what Carriers are reporting for their assessment base. Even assuming the Legislature is able to clarify the situation, one wonders what will happen to the assessments made up through the time the legislature acts. In any event, a significant amount of funds from both the industry's perspective and the state's perspective are at issue.

### *Endnotes*

1. The author would like to thank Austin Neal, an associate in Foley & Lardner's Tallahassee office, for his assistance with this article.
2. In addition to workers' compensation carriers, the assessment for the SDTF is made on certain commercial self-insurers, assessable mutuals, and self-insurers under Chapter 440, Florida Statutes.
3. In addition to workers' compensation carriers, the assessment for the Administration Fund is also made on self-insurers.
4. Fla. Stat. Ann. § 440.49(9)(b)-(c) (West 1998).
5. Fla. Stat. Ann. § 440.51(1)(b) (West 1998).
6. *Id.* at sub. (1)(c).
7. Section 624.5094 of the Florida Insurance Code provides some guidance regarding how "net premiums written" is calculated. It provides:

Notwithstanding any statutory provision to the contrary, for the purposes of calculating the annual assessments for the Special Disability Trust Fund under s. 440.49 . . . , any amount paid or credited as dividends or premium refunds in the same calendar year by the insurer to its policyholders must be deducted from "net premium," "net premiums written," "direct premium," and "net premium collected" for the calendar year. Such offset for dividends or premium refunds paid or credited for the current year must be applied against the current year's net premium for that year's assessment regardless of the policy year for which the dividends or premium refunds are being reimbursed.

However, since the statute speaks to the calculation of "net premium," "direct premium," and "net premium collected," as well as "net premiums written," it appears that it only provides guidance regarding amounts that *must* be deducted in the calculation of any of these premium bases. Therefore, it does not appear to be an exhaustive list of all amounts Carriers can deduct in calculating each of the separate premium bases.

8. After the 1975 amendments to Section 440.49, the relevant provision read:

The net premiums *collected* by the companies on workmen's compensation premiums in this state ... are the basis for computing the amount to be assessed as a percentage of net premiums.

1975 Fla. Laws ch. 75-209 (emphasis added). Only after a 1993 amendment was the SDTF assessment changed to its current basis as a percentage of "net premiums written." *See*, Fla. Laws ch. 93-415, § 43 (eff. January 1, 1994).

9. Fla. Stat. Ann. § 624.510(2) (West 1998) (emphasis added).
10. The Florida Department of Insurance has adopted the Manual for use in conjunction with the preparation of an insurer's annual and quarterly statements. 4 Fla. Admin. Code § 4-137.001(4).
11. Manual, Ch. 14 (1998).
12. Fla. Stat. Ann. § 624.509(1)(a) (West 1998).
13. Fla. Stat. Ann. § 631.54(8) (West 1998) (emphasis added).
14. Rule 4-190.66(4), Florida Administrative Code.
15. "Trust Fund for Comp Administration Facing Real Threats," Florida Workers' Comp Advisor, Vol. 9, No. 2.
16. "Trust Fund for Comp Administration Facing Real Threats," Florida Workers' Comp Advisor, Vol. 9, No. 2.
17. "Large-Deductible WC Programs Challenged in Fla. as Battle Looms Over Assessments," National Underwriter, January 3, 2000.
18. Florida Department of Labor and Employment Security, Division of Workers' Compensation, Bulletin 209, September 22, 1999.
19. *Id.*