

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Committee on Fiscal Policy

BILL: CS/SB 1274

INTRODUCER: Banking and Insurance Committee and Senator Latvala

SUBJECT: Limited Sinkhole Coverage Insurance

DATE: February 26, 2016

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Knudson</u>	<u>Knudson</u>	<u>BI</u>	Fav/CS
2.	<u>Betta</u>	<u>DeLoach</u>	<u>AGG</u>	Recommend: Fav/CS
3.	<u>Pace</u>	<u>Hrdlicka</u>	<u>FP</u>	Pre-meeting

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/SB 1274 creates s. 627.7151, F.S., which allows insurers to offer a new type of sinkhole insurance coverage. Limited sinkhole coverage would, as under current law, only provide coverage for “sinkhole loss,” which is structural damage to the covered building, including the foundation, caused by sinkhole activity. Limited sinkhole coverage would also be subject to the statutory requirements for sinkhole insurance in ss. 627.706-627.7074, F.S., with the following exceptions:

- Coverage is only available for personal lines residential insurance;
- Coverage may be limited to repairs to stabilize the building and repair the foundation;
- Deductibles may be in an amount agreed to by the insured and insurer;
- Policy limits may be in an amount agreed to by the insured and insurer, provided policy limits below \$50,000 are not allowed unless that amount exceeds full replacement costs of the property;
- A notice signed by the applicant is required that the applicant has read and understands the coverages of limited sinkhole coverage, including when insuring for less than replacement cost or agreeing to a deductible greater than allowed in s. 627.706(1)(b), F.S.;
- Insurers are allowed to establish limited sinkhole policy forms not subject to filing with and approval by the Office of Insurance Regulation (OIR);
- Until October 1, 2019, insurers may file rates for limited sinkhole coverage that are not subject to the filing and review requirements of s. 627.062(2)(a) and (f), F.S.;
- Until July 1, 2020, surplus lines agents may export coverage to eligible surplus lines insurers without obtaining three declinations from admitted insurers; and

- A limited sinkhole coverage post loss assignment of benefit is prohibited except to a subsequent purchaser of the property who acquires insurable interest following a loss.

The bill establishes surplus requirements of \$7.5 million for new and existing insurers that solely transact limited sinkhole coverage insurance. Insurers providing limited sinkhole coverage must notify the OIR at least 30 days prior to offering the coverage in the state. Such insurers must file a plan of operation and financial projections or revisions to such plan, as applicable, with the office.

The bill has no fiscal impact on state funds.

II. Present Situation:

2011 Sinkhole Insurance Reforms

From 2006 to 2010 there was a significant increase in the number and cost of sinkhole claims, which impacted the financial stability of property insurers in Florida, including Citizens Property Insurance Corporation (Citizens),¹ and were used by insurers to justify property insurance rate increases.² In response, a number of revisions and clarifications were made to ss. 627.706-627.7074, F.S., which govern sinkhole and catastrophic ground cover collapse insurance. The goal of the revisions was to ensure availability of sinkhole loss coverage for homeowners and provide more certainty in sinkhole claims for insurers.

An actuarial analysis showed that the 2011 reforms would reduce Citizens' expected incurred sinkhole losses for 2013 by almost 55 percent. In Citizens' rate filing for 2014, their actuary projected Citizens' sinkhole losses would decrease by over 52 percent relative to what they would have been without the 2011 reforms.³ The actuary further noted, however, that even with the projected reduction in sinkhole losses, Citizens still has a significant rate deficiency in the sinkhole area. In fact, in 2012, Citizens earned almost \$57 million in sinkhole premium but paid almost \$188 million in sinkhole losses and expenses.

According to data accompanying Citizens 2016 rate filing, in 2014, new sinkhole claim volume was down 68 percent from 2013.⁴ This continued a trend of annual reductions in the number of sinkhole claims filed with the corporation. In 2011, over 4,500 sinkhole claims were reported to Citizens. In 2012, that number decreased to approximately 3,100 claims and in 2013 the total

¹ Citizens Property Insurance Corporation is a state-created, not-for-profit, tax-exempt governmental entity whose public purpose is to provide property insurance coverage to those unable to find affordable coverage in the voluntary admitted market. It is not a private insurance company. See s. 627.351(6), F.S.

² OIR, *Report on Review of the 2010 Sinkhole Data Call by the Office of Insurance Regulation*, Nov. 8, 2010, available at http://www.floir.com/siteDocuments/Sinkholes/2010_Sinkhole_Data_Call_Report.pdf (last visited Feb. 25, 2016).

³ Citizens, *2014 Rate Kit*, pg. 4, available at <https://www.citizensfla.com/documents/20702/124817/2014+Rate+Kit.pdf/7564c271-8e83-427d-8cb4-ca41b67a2e57> (last visited Feb. 25, 2016).

⁴ Citizens, *2016 Rate Kit*, pg. 10, available at <https://www.citizensfla.com/documents/20702/30286/2016+Rate+Hearing+Kit/479c1ab7-f120-47ca-a158-6f908ff36d1a> (last visited Feb. 25, 2016).

claims received was approximately 1,200.⁵ Total incurred losses and allocated loss adjustment expenses have dropped substantially from approximately \$537 million in 2011 to approximately \$83 million in 2014.⁶

Insurance for Sinkholes

A sinkhole is defined as a landform created by subsidence of soil, sediment, or rock as underlying strata are dissolved by groundwater. Sinkholes occur in certain parts of Florida due to the unique geological structure of the land. Sinkholes are formed by movement of rock or sediment into voids created by the dissolution of water-soluble rock.⁷

A sinkhole loss is any structural damage to a covered building, including the foundation, caused by sinkhole activity.⁸ There are five distinct types of damage that constitute structural damage for purposes of determining whether a sinkhole loss has occurred.⁹ Each type of damage is tied to standards contained in the Florida Building Code or used in the construction industry. Accordingly, in order for a policyholder to obtain policy benefits for sinkhole loss, the insured structure must sustain structural damage that is caused by sinkhole activity.

Coverage for Catastrophic Ground Cover Collapse

Currently, property insurers are required to cover catastrophic ground cover collapse, rather than all sinkhole loss, in a base property insurance policy.¹⁰ Catastrophic ground cover collapse is more severe than sinkhole loss. Catastrophic ground cover collapse means geological activity that results in all the following:

- The abrupt collapse of the ground cover;
- A depression in the ground cover clearly visible to the naked eye;
- Structural damage to the covered building, including the foundation; and
- The insured structure being condemned and ordered to be vacated by the governmental agency authorized by law to issue such an order for that structure.¹¹

Insurers may restrict catastrophic ground cover collapse and sinkhole loss coverage to the principal building as defined in the insurance policy.¹²

⁵ Citizens, *Citizens Property Insurance Corporation Actuarial & Underwriting Committee Recommended Rate Filing Executive Summary*, Jun. 23, 2015, pg. 5, available at https://www.citizensfla.com/documents/20702/27059/02_2016_Annual_Recommended_Rate_Filing_Exec_Summary.pdf/57019cdf-e272-4307-b78e-620883395be0 (last visited Feb. 25, 2016).

⁶ *Supra* note 4 at pg. 19.

⁷ Section 627.706(2)(h), F.S.

⁸ Section 627.706(2)(j), F.S. Sinkhole activity is defined as the settlement of systematic weakening of the earth supporting the covered building only if the settlement or systematic weakening results from contemporaneous movement or raveling of soils, sediments, or rock materials into subterranean voids created by the effect of water on a limestone or similar rock formation. Section 627.706(2)(i), F.S.

⁹ Section 627.706(2)(k), F.S.

¹⁰ Section 627.706(1)(a), F.S.

¹¹ Section 627.706(2)(a), F.S.

¹² Section 627.706(1)(c), F.S.

Coverage for Sinkhole losses

Insurers must also offer policyholders, for an appropriate additional premium, sinkhole loss coverage covering any structure, including personal property contents. Such coverage is subject to the insurer's approved underwriting and insurability guidelines and insurers may require a property inspection prior to issuing sinkhole loss coverage.¹³

At a minimum, sinkhole loss coverage includes repairing the covered building, repairing the foundation, and stabilizing the underlying land. All property insurers can restrict catastrophic ground cover collapse and sinkhole loss coverage to the property's principal building. However, Citizens sinkhole loss coverage does not cover sinkhole losses to appurtenant structures, driveways, sidewalks, decks, or patios.

For sinkhole loss coverage in residential property insurance, current law allows insurers to include a deductible that applies only to sinkhole loss in the following amounts: 1 percent, 2 percent, 5 percent, or 10 percent of policy dwelling limits.¹⁴ The insurer has the option to choose which sinkhole loss deductible is offered to policyholders and currently, most insurers, including Citizens, offer policyholders a 10 percent sinkhole loss deductible.

Investigation and Payment of Sinkhole Claims

An insurer must inspect the policyholder's premises to determine if there is structural damage that may be the result of sinkhole activity. Coverage for sinkhole loss is not available if structural damage is not present or sinkhole activity is not the cause of structural damage. The process for payment of a sinkhole claim is as follows:¹⁵

- The insurer must perform an initial inspection and structural damage to determine if there is structural damage which may be the result of sinkhole activity;
- If the insurer cannot determine a valid cause of the structural damage or discovers that the structural damage is consistent with sinkhole loss, sinkhole testing must be performed by a professional engineer or professional geologist;
- The insurer must send a notice to the policyholder detailing the cause of the damage, a statement of the circumstances under which the insurer must conduct sinkhole testing, of the rights of the policyholder to demand sinkhole testing, and the circumstances under which the policyholder may incur costs associated with testing;
- The insurer may deny a sinkhole claim if a determination is made that there is no sinkhole loss;
- A policyholder may demand sinkhole testing in writing within 60 days after receiving a claim denial if the insurer denied the claim without performing sinkhole testing and coverage would be available if a sinkhole loss is confirmed;¹⁶
- The insurer must pay a sinkhole claims if a sinkhole loss is verified:
 - The insurer must pay to stabilize the land and building and repair the foundation in accordance with the recommendation of the professional engineer retained by the insurer;

¹³ Section 627.706(1)(b), F.S.

¹⁴ Section 627.706(1)(b), F.S.

¹⁵ Section 627.707, F.S.

¹⁶ A policyholder that demands sinkhole testing must pay the insurer 50 percent of the sinkhole testing costs up to \$2,500. If the testing confirms a sinkhole loss the insurer must reimburse the testing costs to the policyholder. *See s. 627.707(4)(b), F.S.*

- Payment for other repairs to the structure and contents are governed by the insurance policy;
- The insurer may limit payment to the actual cash value of the sinkhole loss, not including below ground repairs, until the policyholder enters into a contract for the performance of building stabilization repairs;
- The contract for below ground repairs must be made in accordance with the recommendations set forth in the insurer's sinkhole report issued by a professional engineer and entered into within 90 days after the policyholder receives notice that the insurer has confirmed coverage for sinkhole loss;
- The time period is tolled if either party invokes neutral evaluation;¹⁷
- If repairs cannot be completed within policy limits, the insurer may either pay to complete the recommended repairs or tender policy limits without a reduction for repair expenses already incurred.¹⁸

Standards for Sinkhole Testing and Sinkhole Reports

Sinkhole testing must be performed by a professional engineer and a professional geologist. The tests performed must be sufficient for the professional geologist and professional engineer to determine the presence of a sinkhole loss or other cause of damage and enable the professional engineer to make recommendations regarding necessary building stabilization and foundation repair.¹⁹

Upon the completion of sinkhole testing, the professional engineer or professional geologist must issue a report and certification to the insurer and the policyholder that details the testing performed, whether structural damage is present, whether sinkhole activity is the cause of the damage, and any recommendations for stabilizing the land and building and making foundation repairs. The findings and recommendations of the insurer's professional engineer or geologist are presumed to be correct. If an insurer pays a claim for sinkhole loss, the insurer must file a copy of the report and certification and other required documentation with the county clerk of court. Once building stabilization or foundation repairs are complete for a verified sinkhole loss, the engineer responsible for monitoring repairs must issue a report to the policyholder detailing the repairs performed and certify that the repairs were performed properly. The report must also be filed with the county clerk of court.²⁰

¹⁷ Section 627.706(2)(b), F.S., defines "neutral evaluation" as alternative dispute resolution process for sinkhole insurance claims. A neutral evaluator is an engineer that determines the cause of the loss, all methods of above and below ground stabilization and repair, the costs for stabilization and all repairs, and issues a report of the findings and recommendations. Neutral evaluation is nonbinding, but the insurer and policyholder must participate if either party requests it. The recommendation of the neutral evaluator and his or her testimony must be admitted in any litigation relating to the insurance claim. *See* s. 627.7074, F.S.

¹⁸ Section 627.707, F.S.

¹⁹ Section 627.7072, F.S.

²⁰ *See* s. 627.7073, F.S.

Surplus Requirements

To transact insurance in Florida, insurers must apply for a certificate of authority and meet certain surplus requirements. The surplus requirements for existing insurers are different than the requirements for new insurers.²¹ The surplus requirement for current insurers is:

- \$4 million for property and casualty insurers, except for property and casualty insurers authorized to underwrite any line of residential property insurance;
- \$15 million for residential property insurers not holding a certificate of authority before July 1, 2011;
- \$5 million for residential property insurers holding a certificate of authority before July 1, 2011, and until June 30, 2016;
- \$10 million for residential property insurers holding a certificate of authority on or after July 1, 2016, and until June 30, 2021; and
- \$15 million for residential property insurers holding a certificate of authority on or after July 1, 2021.²²

The surplus requirements for a new domestic insurer that transacts residential property insurance are:

- \$15 million if the insurer is not a wholly owned subsidiary of an insurer domiciled in any other state; and
- \$50 million if the insurer is a wholly owned subsidiary of an insurer domiciled in any other state.²³

Rate Filing Requirements

Insurance rates cannot be excessive, inadequate, or unfairly discriminatory.²⁴ The Office of Insurance Regulation (OIR) is responsible for review and approval or disapproval of insurance rates to ensure compliance with the rate standards.²⁵

Insurers must file rates with the OIR pursuant to either the “file and use” or the “use and file” method. Under “file and use,” the insurer files its proposed rate to the OIR at least 90 days before the rate’s effective date but does not implement the rate until it is approved by the OIR. Under

²¹ See ss. 624.407 and 624.408, F.S.

²² Section 624.408, F.S.

²³ Section 624.407(1)(e), F.S.

²⁴ Section 627.062(1), F.S. The rating requirements for property, casualty, and surety insurance are located in part I of ch. 627, F.S., entitled the “Rating Law,” and apply to property, casualty, and surety insurance.

²⁵ Section 627.062(2)(b), F.S. The OIR must determine if the rate is excessive, inadequate, or unfairly discriminatory. In making this determination the OIR must consider the following factors: past and prospective loss experience in Florida and in other jurisdictions; past and prospective expenses; degree of competition to insure the risk; investment income reasonably expected by the insurer; reasonableness of the judgment reflected in the filing; dividends, savings, or unabsorbed premium deposits returned to Florida insureds; adequacy of loss reserves; cost of reinsurance; trend factors, including those for actual losses per insured unit; catastrophe and conflagration hazards, when applicable; projected hurricane losses, if applicable; a reasonable margin for underwriting profit and contingencies; cost of medical services, when applicable; and other relevant factors impacting frequency and severity of claims or expenses.

“use and file,” the insurer may implement the rate before filing for OIR approval, but must submit the filing within 30 days of the rate’s effective date.²⁶

III. Effect of Proposed Changes:

Limited Sinkhole Coverage Insurance

The bill creates s. 627.7151, F.S., which allows insurers to offer limited sinkhole coverage insurance, a new type of sinkhole insurance coverage. Limited sinkhole coverage insurance would only provide coverage for the peril of sinkhole loss on any structure or the contents of personal property contained therein. Sinkhole loss is structural damage to the covered building, including the foundation, caused by sinkhole activity.²⁷ The bill provides that limited sinkhole coverage insurance:

- Is authorized for personal lines residential insurance;
- Is not authorized for commercial lines residential insurance (such as condominium association and homeowners association coverages) or commercial lines nonresidential insurance;
- May exclude coverage for contents and additional living expenses;
- Does not apply to excess coverage over any other insurance covering the peril of sinkhole loss; and
- Is subject to the statutory requirements for sinkhole insurance in ss. 627.706-627.7074, F.S., except as otherwise provided in the bill.

Scope of Benefits Provided

Currently, insurers are required to pay for building stabilization and foundation repair and other repairs to the structure and contents in accordance with the terms of the policy.²⁸ The bill limits coverage to repairs to stabilize the building and repair the foundation in accordance with recommendations of a professional engineer retained pursuant to s. 627.707(2), F.S.

Similar to current law in s. 627.707, F.S., the bill requires, if the insurer’s professional engineer determines that the repair cannot be completed within policy limits, the insurer to pay to complete the repairs recommended by the insurer’s professional engineer or tender the policy limits to the policyholder. However, when below-ground sinkhole remediation repairs begin and the engineer selected by the insurer determines that repairs cannot be completed within policy limits, the bill requires the insurer to complete the repairs regardless of the policy limit or tender the full policy limit. The bill does not address whether the insurer must tender the full policy limit without reduction for the repairs already performed, as required in current s. 627.707(5)(c), F.S.

²⁶ Section 627.062(2)(a), F.S. Under “use and file,” if a portion of the rate is subsequently found by the OIR to be excessive, the insurer must refund to policyholders the portion of the rate that is excessive.

²⁷ Section 627.706(2)(j), F.S.

²⁸ Section 627.707(5), F.S.

Deductibles and Policy Limits

Currently, sinkhole deductibles may only be 1 percent, 2 percent, 5 percent, or 10 percent of the dwelling policy limits. In addition to these deductibles, limited sinkhole coverage insurance may offer a deductible in any amount agreed to by the insured and insurer.

Limited sinkhole coverage insurance may offer a policy limit in any amount agreed to by the insured and insurer as long as the limit is between \$50,000 and the full replacement cost of the property. A policy limit may be below \$50,000 if that amount exceeds the full replacement costs.

Notice to Policyholders

The bill requires insurance agent to obtain from an applicant for limited sinkhole coverage insurance a signed acknowledgment that contains the following statement in at least 12-point bold, uppercase type: “BY ACCEPTING THIS LIMITED SINKHOLE COVERAGE INSURANCE POLICY I HAVE READ AND UNDERSTAND THE LIMITATIONS THAT APPLY TO MY POLICY.”

The bill also requires the signed acknowledgment to include specific notices to the policyholder if the policy limit is less than replacement cost or contains a deductible greater than ten percent.

Exemption from Form and Rate Approval

The bill allows insurers to establish limited sinkhole coverage policy forms, which are not subject to filing and approval by the OIR.

The bill allows insurers to develop rates for limited sinkhole coverage under the OIR’s full filing and rate review process or for rates filed before October 1, 2019, to develop and use rates in accordance with the rates, rating schedules, and rating manuals filed by the insurer that allow for a reasonable rate of return on policies written in Florida.

Under the latter option the insurer’s rates are exempt from the OIR’s full filing and review process. However, these insurers must:

- Notify the OIR of any change to sinkhole insurance rates, within 30 days after the effective date of the rate change and include the average statewide percentage change in rates;
- Maintain actuarial data regarding sinkhole insurance rates for 2 years after the effective date of those rates; and
- Have their rates examined by the OIR to ensure that the rates are not excessive, inadequate, or unfairly discriminatory.²⁹ The OIR may require the insurer to pay for the examination.

²⁹ See ss. 627.062(2)(b) and (e), F.S. During an examination, the OIR uses the rate factors and standards that apply to property, casualty and surety insurance rates filed with the OIR to determine whether the sinkhole insurance rate charged is excessive, inadequate, or unfairly discriminatory. Setting sinkhole rates using this method is similar to what is allowed in current law for flood insurance rates and certain types of commercial lines risks under s. 627.062(3)(d), F.S.

Surplus Lines

Currently, no insurance coverage is eligible for export to a surplus lines insurer³⁰ unless it meets certain conditions.³¹ One condition is that an agent has sought coverage from and received 3 documented rejections from authorized insurers currently writing the same type of coverage. Until July 1, 2020, the bill allows this new sinkhole coverage for personal lines residential property to be written by a surplus lines insurer without the agent obtaining 3 declinations for insurance from Florida licensed sinkhole insurers. This provision is similar to the language in place for flood insurance regarding surplus lines insurers. However, the other requirements governing the exporting of coverage to the surplus lines continue to apply.

Regulatory Requirements

Insurers providing limited sinkhole coverage must notify the OIR at least 30 days before writing sinkhole insurance in Florida. Insurers must also file a plan of operation and financial projections or revisions to such plan, as applicable, with the OIR.

Assignment of Post-Loss Benefits

The bill prohibits a policyholder of a limited sinkhole coverage insurance policy to assign a post-loss claim except to a subsequent purchaser of the property who acquires an insurable interest following a loss.

Surplus Requirements

The bill amends ss. 624.407 and 624.408, F.S., to reduce the surplus requirement for new and existing insurers that only transact limited sinkhole coverage insurance for personal lines residential property to \$7.5 million.

Effective Date

The bill is effective July 1, 2016.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

³⁰ Section 626.914, F.S., defines “surplus lines insurer” as an unauthorized insurer that has been made eligible by the OIR to write certain property and casualty insurance business when such insurance is not procurable to be written by an authorized insurer. *See also* s. 626.918, F.S.

³¹ Under s. 626.915, F.S., surplus lines may be procured subject to the following conditions: the insurance must be eligible for export; the insurer must be an eligible surplus lines insurer; the insurance must be so placed through a licensed Florida surplus lines agent; and other applicable provisions of this surplus lines law must be met. *See also* s. 626.916, F.S.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The fiscal impact on the private sector is unknown. The limited sinkhole insurance created by the bill may be more readily available in sinkhole-prone areas of the state such as Hillsborough, Pinellas, Pasco, and Hernando counties. If insurers offering this new sinkhole insurance raise deductibles and initiate limits on coverage, policyholders may have lower premiums. However, if a policyholder experienced a sinkhole, the out-of-pocket costs to the policyholder may be higher than if the policyholder currently has existing sinkhole insurance. For policyholders who currently lack sinkhole insurance, the coverage provided by limited sinkhole insurance would reduce out-of-pocket expenses.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 624.407 and 624.408.

This bill creates section 627.7151 of the Florida Statutes.

IX. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

See PCS 424308 by Fiscal Policy (Recommended by Appropriations Subcommittee on General Government) on February 24, 2016.

CS by Banking and Insurance on February 9, 2016:

- Limited sinkhole coverage is not required to insure the contents of personal property or additional living expenses.
- Removes the requirement that contents of personal property be adjusted at replacement cost and not actual cash value.
- Allows for limited sinkhole coverage to repair and stabilize the building and foundation in accordance with the recommendations of a professional engineer. If repairs cannot be completed within policy limits, the insurer must pay to complete the repairs or tender the policy limits to the policyholder.
- Allows a deductible in an amount agreed to by the insured and insurer.
- Allows policy limits agreed to by the insured and insurer, provided policy limits below \$50,000 are not allowed unless that amount exceeds full replacement costs of the property.
- Requires a signed notice by an applicant that they have read and understand the coverages of limited sinkhole coverage, including when insuring for less than replacement cost or agreeing to a deductible greater than allowed in s. 627.706(1)(b), F.S.
- Allows limited sinkhole insurers to establish their own forms without needing approval by the Office of Insurance Regulation (OIR).
- Removes the prohibition that Citizens must stop writing sinkhole coverage after July 1, 2018.
- Removes the requirement that the Florida Commission on Hurricane Loss Projection Methodology approve sinkhole models.
- Removes an erroneous statement that the Florida Hurricane Catastrophe Fund cannot cover sinkhole loss.

B. Amendments:

None.