

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/CS/HB 1243 Citizens Property Insurance Corporation

SPONSOR(S): Economic Affairs Committee, Insurance & Banking Subcommittee, Boyd and others

TIED BILLS: **IDEN./SIM. BILLS:** SB 1714

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	11 Y, 3 N, As CS	Callaway	Cooper
2) Economic Affairs Committee	10 Y, 6 N, As CS	Callaway	Tinker

SUMMARY ANALYSIS

Citizens Property Insurance Corporation (Citizens or 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.

As of January 31, 2011, Citizens is the largest property insurer in Florida with over 1.3 million policies extending approximately \$462 billion of property coverage to Floridians. As of June 30, 2010, Citizens represented approximately 18 percent of the residential property admitted market based on insured value for policies.

The bill makes numerous changes to Citizens. Many of the changes will reduce the number of policies in Citizens, as well as reduce the exposure and losses of Citizens. The changes include:

- Changing legislative intent and findings relating to Citizens;
- Limiting the eligibility for Citizens based on premium amount charged by a private market insurer;
- Limiting the eligibility for Citizens based on the value of the property insured;
- Requiring flood insurance for certain Citizens' policyholders;
- Providing policyholders of Citizens assumed by a private market insurer are ineligible for insurance in Citizens until the end of the assumption agreement;
- Allowing surplus lines insurers to remove policies from Citizens under specified conditions;
- Repealing a reduction of Citizens' wind-only zones;
- Adding parameters to voting by members of the Citizens' board;
- Allowing certain Citizens' board members to be exempt from the conflicting employment or contractual relationship law that applies to public officers and agency employees;
- Requiring additional reporting by the Citizens' Market Accountability Advisory Committee;
- Requiring a report on outsourcing Citizens' claims functions;
- Repealing the quota share program in Citizens;
- Amending the appointment requirements for insurance agents selling insurance in Citizens;
- Preventing Citizens from insuring attached or detached screen enclosures;
- Increasing the Citizens' rate cap from 10 percent to 15 percent per policyholder;
- Sunsetting the rate cap on January 1, 2015;
- Exempting sinkhole coverage and the cost of reinsurance from the rate caps;
- Requiring an industry expense equalization factor in Citizens' rates;
- Requiring Citizens' applicants and policyholders be apprised of and acknowledge the assessment potential of an insurance policy written by Citizens;
- Amending the levy of and responsibility for a Citizens' Policyholder Surcharge;
- Increasing the amount of an emergency assessment levied against policyholders of Citizens;
- Specifying Citizens cannot be liable for bad faith or extra-contractual damages; and
- Prohibiting Citizens from covering losses to appurtenant structures, driveways, sidewalks, decks, or patios caused by sinkholes.

The bill has no fiscal impact on state or local government. The bill will impact the private sector. This impact is addressed in the Fiscal Analysis section of the staff analysis.

The bill is effective upon becoming a law.

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

STORAGE NAME: h1243c.EAC

DATE: 4/13/2011

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Citizens Property Insurance Corporation

Citizens Property Insurance Corporation (Citizens or 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.

As of January 31, 2011, Citizens is the largest property insurer in Florida with over 1.3 million policies extending approximately \$462 billion of property coverage to Floridians.¹ As of June 30, 2010, Citizens represented approximately 18 percent of the residential property admitted market based on insured value for policies.²

Citizens was created by the Legislature in 2002 by the merger of two existing property insurance associations: The Florida Residential Property and Casualty Joint Underwriting Association (FRPCJUA) and the Florida Windstorm Underwriting Association (FWUA). The FRPCJUA provided full-coverage personal and commercial residential property policies in all counties of Florida while the FWUA provided personal and commercial residential property wind-only coverage in designated territories.

The bill repeals and rewrites much of the Legislative findings and intent relating to Citizens, in part, to be consistent with the changes made by the bill to the eligibility standards for Citizens. The changes made to these standards, detailed later in the analysis, move Citizens from a market of affordability to a market of last resort over a period of time.

Eligibility for Insurance in Citizens

Citizens writes various types of property insurance coverage for its policyholders. The types of coverage are divided into three separate accounts within the corporation:

1. Personal Lines Account (PLA) – Multiperil Policies³
Consists of homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners and similar policies;
2. Commercial Lines Account (CLA) – Multiperil Policies
Consists of condominium association, apartment building, homeowner's association policies, and commercial non-residential multiperil policies on property located outside the High-Risk Account area; and
3. High-Risk Account (HRA) – Wind-only⁴ and Multiperil Policies
Consists of wind-only and multiperil policies for personal residential, commercial residential, and commercial non-residential issued in limited eligible coastal areas.

Citizens does not insure damage from flooding. Most flood insurance is provided by the Federal Emergency Management Agency through the National Flood Insurance Program. Under current law, Citizens' policyholders do not have to purchase flood insurance in order to be insured by Citizens. However, if flood insurance is not purchased by the Citizens' policyholder, the policyholder must execute a form acknowledging the Citizens' policy does not cover flood damage. Starting January 1,

¹ <https://www.citizensfla.com/> (last viewed February 27, 2011).

² Meeting materials from Citizens presented at the Insurance & Banking Subcommittee meeting held on January 12, 2011.

³ A multi-peril policy is defined as a package policy, such as a homeowners or business insurance policy that provides coverage against several different perils. It also refers to the combination of property and liability coverage in one policy. (<http://www2.iii.org/glossary/>) Multi-peril property insurance policies include coverage for damage from windstorm and from other perils, such as fire, theft, and liability.

⁴ A wind-only policy is a property insurance policy that provides coverage against windstorm damage only. Coverage against non-windstorm events such as fire, theft, and liability are available in a separate policy.

2012, the bill requires new applicants for Citizens' property insurance located in specified flood hazard areas to have flood insurance. The bill specifies the coverage limits required for the flood insurance. Exceptions to the flood insurance requirement are provided in the bill. Starting January 1, 2013, current Citizens' policyholders must have flood insurance in order to keep their property insurance with Citizens.

Eligibility Based on Premium Amount

An applicant for residential insurance coverage with Citizens is eligible even if the applicant has an offer of coverage from an insurer in the private market at its approved rates. In this case, a homeowner can buy insurance from Citizens if the premium for the offer of coverage in the private market is more than 15 percent than the premium Citizens would charge for comparable coverage.⁵ There is no similar eligibility restriction for commercial non-residential property and none is provided in the bill.

For residential property insured by Citizens prior to January 1, 2015, the bill changes the premium eligibility threshold to 25 percent, allowing Citizens to insure property if the premium charged by a private insurer to insure the property is more than 25 percent than the premium Citizens would charge for comparable coverage. After January 1, 2015, no property can be insured by Citizens if an authorized insurer⁶ in the private market offers to insure the property.

Eligibility Based on Value of Property Insured

Citizens currently has eligibility restrictions for homes and condominium units based on the value of the property insured. These restrictions are in addition to the 15 percent premium eligibility restriction. In the personal lines account (i.e., mostly inland areas), Citizens currently does not insure a home or condominium unit if the insured value of the dwelling is \$1 million or more.⁷

In the high risk account (i.e., certain coastal areas), Citizens does not insure homes or condominium units if the insured value of the dwelling is \$2 million or more.⁸ Starting January 1, 2012, the bill reduces this insured value limit to \$1 million, preventing Citizens from insuring homes or condominium units in certain coastal areas if the dwelling insured value is \$1 million or more.

For property statewide, the bill reduces the insured value limit for personal lines residential property to \$750,000 or more starting January 1, 2014 and \$500,000 or more starting January 1, 2016. Thus, homes or condominium units, wherever located, cannot obtain insurance in Citizens if the home or condominium unit is insured for \$750,000 or more starting in 2014 and \$500,000 or more starting in 2016.

Citizens does not have any eligibility restrictions based on the value of the property insured for condominium association, homeowner association, or apartment building policies and the bill does not add any such restrictions for these properties.

Citizens has multiple eligibility and coverage restrictions for commercial businesses, depending on where the business is located and the type of policy the business purchases from Citizens. The restrictions are contained in the underwriting rules of Citizens, not in the statute. The bill does not add any eligibility restrictions based on the value of the property insured for commercial businesses.

Citizens' Wind-Only Policies

Citizens provides coverage in the high risk account for specially designated areas, called wind-only zones,⁹ which have been determined to be particularly vulnerable to severe hurricane damage. In

⁵ s. 627.351(6)(c)5.a., F.S. Commercial non-residential property is not subject to this eligibility restriction.

⁶ Authorized insurer is defined in s. 624.09, F.S., as an insurer receiving a certificate of authority by the Office of Insurance Regulation to transact insurance in Florida. Florida law also recognizes surplus lines insurers. These insurers are not "authorized" insurers. Rather, surplus lines insurers are "unauthorized" insurers, but are eligible to transact surplus lines insurance under the surplus lines law as "eligible surplus insurers". Thus, a policyholder can remain eligible for insurance in Citizens after January 1, 2015 if the only offer of insurance the policyholder receives from the private market is one from a surplus lines insurer.

⁷ This restriction is pursuant to an underwriting rule.

⁸ This restriction is pursuant to statute (s. 627.351(6)(a)3., F.S.).

⁹ Also called windstorm areas or windstorm boundaries.

these areas, a property owner can obtain a property insurance policy from Citizens covering property damage from only wind events and can obtain a property insurance policy from a private market insurance company covering property damage and liability from non-wind events (other peril/non-wind coverage).

The wind-only zones that currently exist have evolved over three decades, but originated with the creation of the FWUA in 1970. The FWUA was created to cover residential and commercial policyholders unable to secure windstorm coverage in the voluntary market. This coverage was limited to defined geographical areas in the state determined by the then Department of Insurance (Department). Eligibility was limited to structures in areas found by the Department, after public hearings, to meet three criteria:

- the lack of windstorm coverage in the area was deterring development, causing mortgages to be in default, and causing financial institutions to deny loans;
- the area was subject to the requirements of the Southern Standard Building Code or its equivalent; and
- extending windstorm coverage to the area was consistent with the policies and objectives of environmental and growth management.

The wind-only zones currently apply to 29 Florida counties. When the wind-only zones were established, only Monroe County was included. In 1992, when Hurricane Andrew hit South Florida, the wind-only zone did not include Miami-Dade, Broward, or Palm Beach counties. After Hurricane Andrew, the Department and the Legislature expanded the boundaries of the wind-only zones to the current ones. In July 2002, when Citizens was created, Citizens maintained the wind-only zones from the FWUA.

As noted previously, in the wind-only zones private insurers may offer other peril/non-wind coverage, but are not required to provide windstorm coverage. Under current law,¹⁰ beginning December 1, 2010, if Citizens' 100 year probable maximum loss¹¹ (PML) for the wind-only policies is not 25 percent less than the PML in February 2001, Citizens must reduce the boundaries of the wind-only zones so that the PML reaches that amount. Current law requires a further PML reduction by February 1, 2015. If Citizens' 100-year PML is not 50 percent less than the PML in February 2001 by February 1, 2015, the boundaries of the wind-only zones are restricted to only areas seaward of 1,000 feet from the Intercoastal Waterway.

Citizens was not able to reduce its PML by the required 25 percent by December 1, 2010. One reason Citizens could not reduce the PML is because Citizens has grown, in part, due to the reluctance of private insurers to expand their writings in Florida because of the significant losses sustained in the 2004 and 2005 hurricane seasons. Although Citizens developed a plan to reduce the wind-only zones as the statute directs, the plan has not been implemented. Once Citizens implements the plan, private insurers writing the other peril (non-wind coverage) in the current wind-only zones must either drop that coverage or write the windstorm coverage for policies.

The bill repeals current law requiring the Citizens to reduce the wind-only zones if the Citizens' PML is not reduced by December 1, 2010 and February 1, 2015.

Citizens' Board of Governors

Citizens operates under the direction of an 8-member Board of Governors. The Governor, Chief Financial Officer, Senate President, and Speaker of the House of Representatives each appoint two members of the Board. Board members serve 3-year staggered terms.¹² At least one of the two board members appointed by each appointing officer must have demonstrated expertise in insurance. The board members are not Citizens' employees and are not paid.

¹⁰ s. 627.351(6)(y), F.S. This law was enacted in 2002.

¹¹ Probable maximum loss is an estimate of maximum dollar value that can be lost under realistic situations.

¹² s. 627.351 (6)(c)4., F.S.

The bill prohibits Citizens' board members from voting on any measure before the board that would inure:

- to the gain or loss of the board member;
- to the gain or loss of any principal retaining the board member;
- to the gain or loss of a parent or subsidiary organization of the principal retaining the board member; or
- to the gain or loss of a relative or business associate of the board member.

When the board member abstains from voting, the member must state the nature of the interest in the matter which the member is abstaining from and disclose the nature of the interest in a memorandum filed with the person responsible for recording the Citizens' board meeting minutes.

The bill further provides Citizens' board members with the required insurance expertise fall within the exemption in the conflicting employment or contractual relationship statute that applies to public officers and agency employees.¹³ Thus, the bill allows Citizens' board members with insurance expertise to maintain employment in the private sector in jobs involving business with Citizens without violating the conflict of interest statute because the board member is required by law to have insurance expertise in order to sit on the board.

Market Accountability Advisory Committee

Citizens' board must establish a Market Accountability Advisory Committee (Committee) to advise the board on the comparison of Citizens' rates and customer and agent service levels to the private market. The Committee gives the board a report on these issues at every board meeting. The bill requires the Committee to also advise and report to the board on insurance agent appointments and compensation.

Outsourcing of Claims Functions

As of December 2010, Citizens has over 1,160 employees in-house, and almost 8,500 insurance agents selling Citizens' insurance. Citizens handled almost 1.7 million calls in 2010. Citizens has in-house claims adjusters on staff and has contracts with external independent adjusting firms. Both in-house and outside adjusters handle daily claims for Citizens. Catastrophe claims are all handled by independent adjusters, with Citizens staff overseeing and directing the independent adjusters.¹⁴

Virtually all of Citizens' claims adjusting was outsourced prior to the 2004 and 2005 hurricanes. During the 2004 hurricane season, Citizens' Catastrophe Claims Team consisted of two Citizens' employees and 1,230 contracted independent adjusters. During the 2005 hurricane season, Citizens' Catastrophe Claims Team consisted of eight Citizens' employees and 2,001 contracted independent adjusters.¹⁵ Although Citizens had a large number of claims adjusters under contract, after the 2004 and 2005 hurricanes, many of these adjusters broke their contracts with Citizens in order to adjust claims for private insurers. Thus, Citizens' policyholders experienced delays in claim adjusting and payment. To strengthen its ability to handle catastrophe claims, since 2005, Citizens has hired more in-house claims staff and contracted with many more independent adjusters. In 2010, Citizens' Catastrophe Claims Team consisted of 18 Citizens' employees and over 4,500 contracted independent adjusters.¹⁶

The bill requires a third party to report on the costs and benefits of outsourcing Citizens' policy issuance and service functions to outside parties for a fee. Service functions include claims handling. The outsourcing report is due to the Citizens' board by July 1, 2012. The board must develop a plan to implement the report and submit the implementation plan to the Financial Services Commission (Commission). Citizens must implement the plan by January 1, 2013, after the Commission's approval.

¹³ Board members of Citizens fall under the definition of "public officer" in s. 112.313(1), F.S., because that definition includes any person appointed to hold office in any agency, including serving on an advisory board. "Agency" is defined in s. 112.312, F.S.

¹⁴ Information obtained from a representative of Citizens, on file with the Insurance & Banking Subcommittee.

¹⁵ Task Force on Citizens Property Insurance Claims Handling and Resolution, First Report, dated July 2, 2007, available at <http://www.taskforceoncitizensclaimshandling.org/images/FirstReport.pdf> (last viewed March 14, 2011).

¹⁶ Citizens has other claims personnel that can be moved to catastrophe operations if needed (Information received from Citizens on March 26, 2011).

Quota Share Program in Citizens

Under current law, Citizens must adopt a quota share program for hurricane coverage provided by Citizens. With a quota share program, Citizens is responsible for a specified percentage of hurricane coverage on a property and a private insurer is responsible for the remaining percentage. The Citizens' quota share program in current law is only available for residential properties located in the high-risk account and Citizens is responsible for either 90 percent or 50 percent of the hurricane coverage. Although authority for a quota share program is contained in law, Citizens does not have any insurer participating in the program and has never had an insurer participate in the program.¹⁷ Thus, the bill repeals the authority for the quota share program in Citizens and the program requirements.

Depopulation of Citizens

Under current law, Citizens is authorized to develop and maintain a depopulation program to reduce the number of its insured properties and financial exposure.¹⁸ Depopulation allows Citizens to transfer policies back to the private insurance market. In 2009, almost 150,000 policies were removed from Citizens by licensed insurance companies in the private market under the Citizens' depopulation program.

The depopulation program encourages insurance companies licensed in Florida to assume policies currently covered by Citizens. However, current law allows a Citizens policyholder to remain with Citizens even though the policyholder receives an offer of coverage (assumption) from a insurance company in the private market that is licensed in Florida.¹⁹ The bill deletes this provision. Thus, Citizens' policyholders assumed by an insurer licensed in Florida must accept the insurance offered by the licensed insurer and cannot remain insured in Citizens for the remainder of their policy term.

The bill allows surplus lines insurers to take policies out of Citizens through depopulation. Surplus lines insurers are not allowed to participate in the Citizens' depopulation program under current law because the program is limited to insurers licensed in Florida and surplus lines insurers are not licensed in Florida, but are eligible to transact insurance in Florida.²⁰ Unlike the bill's provision requiring a Citizens' policyholder to accept an offer of insurance by a licensed insurer, a Citizens' policyholder offered coverage by a surplus lines insurer does not have to accept the insurance offered by the surplus lines insurer and can remain in Citizens if the policyholder declines.

Only surplus lines insurers meeting specified financial criteria are allowed to take policies out of Citizens. The bill requires the surplus lines insurer removing policies from Citizens to provide prominent notice to the Citizens' policyholder before the insurer assumes the policy stating the surplus lines policy is not covered by the Florida Insurance Guaranty Association.²¹

The surplus lines insurer must offer the Citizens' policyholder a policy with similar coverage as Citizens and must notify the Citizens' policyholder of the differences in coverage offered by the insurer and the Citizens' policy.

The bill requires Citizens to release relevant underwriting files and claims files to any insurer (Florida licensed or surplus lines) that has taken a policy out of Citizens or is considering taking a policy out of Citizens, as long as the insurer agrees in writing to maintain the confidentiality of the files.

¹⁷ Phone conversation with a representative of Citizens on March 9, 2011.

¹⁸ s. 627.351(6)(q)3., F.S.

¹⁹ A Citizens' policyholder cannot be removed from Citizens by a private insurer licensed in Florida if the policyholder's insurance agent is not appointed by the insurer removing the policy from Citizens. (See s. 627.3517, F.S.)

²⁰ Surplus lines insurers are not "authorized" insurers, meaning they are not licensed by the OIR to transact insurance in Florida. Rather, surplus lines insurers are "unauthorized" insurers, but are eligible to transact surplus lines insurance under the surplus lines law as "eligible surplus insurers." Claims against insurance policies issued by surplus lines insurers cannot be paid by the Florida Insurance Guaranty Association if the surplus lines insurer becomes insolvent.

²¹ Generally, the Florida Insurance Guaranty Association pays claims of policyholders insured by licensed Florida insurers if the insurer becomes insolvent.

Citizens' Agent Appointments

Citizens sells insurance via licensed insurance agents appointed by the corporation. As of December 2010, almost 8,500 insurance agents were appointed by Citizens to sell insurance in Citizens. Under current law, in order for an agent to be appointed by Citizens, at the time of the agent's initial appointment with Citizens, the agent must also be appointed by a private insurer who is writing property insurance in Florida. The bill removes the requirement that the private insurer must be writing property insurance in Florida at the time of the agent's initial appointment with Citizens. Thus, each year in order for an agent to be appointed by Citizens, the agent must also be appointed by a private insurer who is writing property insurance in Florida.

Coverage Provided by Citizens for Screen Enclosures

Starting January 1, 2012, the bill prohibits Citizens from insuring attached or detached screen enclosures. Citizens currently insures screen enclosures. Although provisions in current law restrict the amount of Citizens' coverage for specific items, such as restricting coverage for mobile or manufactured homes built before 1994 to actual cash value, no provision in current law completely prohibits Citizens from covering specific items.

Rates Charged by Citizens

Current law requires Citizens' rates to be actuarially sound. Citizens' rates are set by the Office of Insurance Regulation (OIR) based on a rate filing made by Citizens setting out actuarially sound rates for the corporation. However, although current law requires Citizens' rates to be actuarially sound, the law also restricts Citizens' rates from increasing more than 10 percent a year per policy until the rates are actuarially sound. Once the rates are actuarially sound, the rate increase percentage is not capped.

Citizens' rates were frozen by law at 2005 levels from January 2007 to December 31, 2009.²² Citizens implemented an overall statewide average rate increase of 10.3 percent to be implemented in 2011 for homeowners in the PLA and HRA.²³ Citizens implemented an overall statewide average rate increase of 5.4 percent for implementation in 2010 for homeowners in the PLA.²⁴ Citizens implemented an overall statewide average rate increase of 5.2 percent for implementation in 2010 for homeowners in the HRA.²⁵

The bill revamps current law relating to Citizens' rates. The bill provides legislative intent that Citizens' rates are actuarially determined and not competitive with rates charged in the private market. The bill maintains current law requiring Citizens' rates to be actuarially sound. The bill requires the OIR to establish Citizens' rates each year based on recommended rates filed with the OIR by Citizens.

Starting July 1, 2011, the bill increases the current cap on Citizens' rate increases. The cap is increased from 10 percent a year per policy to 15 percent a year per policy.

The new rate caps apply only from July 1, 2011 until January 1, 2015. After that date, there is no cap on Citizens' rate increases. In addition, the new rate cap does not apply to sinkhole coverage or costs for reinsurance. Thus, between July 1, 2011 and January 1, 2015, rates for a Citizens' policyholder can increase more than 15 percent per policy if the policyholder purchases sinkhole coverage from Citizens and a rate increase of more than 15 percent is actuarially justified for the sinkhole risk. Similarly, between July 1, 2011 and January 1, 2015, Citizens' rates for all policyholders can increase more than 15 percent per policy if Citizens' purchases reinsurance and a rate increase in excess of the rate cap is actuarially justified due to the reinsurance purchase.

²² s. 627.351(6)(m)4., F.S.

²³ Press Release from the OIR dated September 23, 2010 available at <http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=3699> (last viewed March 24, 2011).

²⁴ Press Release from the OIR dated October 30, 2009 available at <http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=3321> (last viewed March 24, 2011).

²⁵ Press Release from the OIR dated November 20, 2009 available at <http://www.floir.com/PressReleases/viewmediarelease.aspx?ID=3339> (last viewed on March 24, 2011).

In addition, Citizens' required use of the public hurricane loss projection model to calculate the lowest rates for the windstorm portion of Citizens' rates is repealed.

The bill requires Citizens to include an industry expense equalization factor in rates. This factor must include a catastrophe risk load, taxes, reinsurance costs, general expenses, acquisition expenses, and commissions, even if Citizens does not incur these expenses. Because Citizens is a not for profit corporation, is tax exempt, and does not have to meet the solvency requirements like private insurers, Citizens' expenses are generally lower than that of private insurers. Including an industry expense equalization factor in Citizens' rates should equalize the expenses for Citizens with the expenses for private insurers. Higher expenses generally result in higher rates. Thus, an equalization of expense factors should provide a fairer comparison of Citizens' rates to the private insurers' rates and prevent Citizens' rates from being lower than the private market due to lower expenses incurred by the Citizens.

Financial Resources to Pay Claims²⁶

Citizens' financial resources include both resources typically available to private insurance companies and resources uniquely available to Citizens as a governmental entity with the statutory authority to levy assessments in the event of a deficit in Citizens' financial resources. Like typical private insurance companies, Citizens' financial resources include:

- insurance premiums;
- investment income;
- accumulated surplus;
- reimbursements from the Florida Hurricane Catastrophe Fund due to Citizens' purchase of reinsurance from the Florida Hurricane Catastrophe Fund; and
- reimbursements from private reinsurance companies if Citizens purchases private reinsurance.

Financial resources unique to Citizens include: Citizens Policyholder Surcharges, regular assessments, and emergency assessments.

Citizens projects the corporation will have \$5.4 billion in surplus to pay claims during the 2011 hurricane season.²⁷ In addition, Citizens could be reimbursed another \$6.35 billion for claims it pays by the Florida Hurricane Catastrophe Fund. Thus, the maximum amount Citizens has to pay claims for the 2011 hurricane season is approximately \$11.75 billion.²⁸

As of January 31, 2011, Citizens' total exposure is almost \$462 billion. Citizens estimates the 1-in-100 year hurricane would cost over \$23.4 billion.²⁹ The \$11.65 billion difference between Citizens' resources to pay claims (\$11.75 billion) and its 1-in-100 year exposure (\$23.4 billion) would be covered by assessments levied by Citizens on its own policyholders and on policyholders of most property and casualty insurance.

Assessments Levied by Citizens

In the event Citizens incurs a deficit (i.e. its obligations to pay claims exceeds its capital plus reinsurance recoveries), it may levy assessments on most of Florida's property and casualty insurance policyholders in a specific sequence set by statute.³⁰ The three Citizens' accounts calculate deficits and resulting assessment needs independently.

²⁶ All Citizens' projections about claims paying capacity for the 2011 hurricane season are found in meeting materials from Citizens presented at the Insurance & Banking Subcommittee meeting held on January 12, 2011.

²⁷ Meeting materials from Citizens presented at the Insurance & Banking Subcommittee meeting held on January 12, 2011.

²⁸ Although Citizens has another \$2.9 billion in pre-event bonding that would be available to pay claims, this bonding would have to be repaid through assessments, so is not included in the calculations. If this amount were included, Citizens would have \$14.672 billion to pay claims during the 2011 hurricane season.

²⁹ A 1-in-100 year hurricane has a 1 percent probability of occurring.

³⁰ s. 627.351(6)(b)3.a.,d., and i., F.S.

Citizens Policyholder Assessments

If Citizens incurs a deficit, Citizens will first levy surcharges on its policyholders of up to 15 percent of premium per account in deficit, for a maximum total of 45 percent. This surcharge is collected over twelve months and is collected at the time a new Citizens' policy is written or an existing Citizens' policy is renewed. Thus, a policyholder insured by Citizens when the Citizens Policyholder Surcharge is levied is subject to the surcharge only if the policyholder renews with Citizens during the 12 month surcharge collection period.

Regular Assessments

Upon the exhaustion of the Citizens Policyholder Assessment for a particular account, Citizens may levy a regular assessment of up to 6 percent of premium or 6 percent of the deficit per account, for a maximum total of 18 percent.³¹ The regular assessment is levied on virtually all property and casualty policies in the state, but is not levied on Citizens' policies. The assessment is also not levied on workers' compensation, medical malpractice, accident and health, crop or federal flood insurance policies. Mechanically, property casualty insurers with policies subject to the regular assessment "front" the assessment to Citizens and recover it from their policyholders at the issuance of a new policy or at renewal of existing policies. Thus, Citizens will collect funds raised by a regular assessment quickly after the assessment is levied, usually within 30 days after levy.

Emergency Assessments

Upon the exhaustion of the Citizens Policyholder Assessment and regular assessment for a particular account, Citizens may levy an emergency assessment of up to 10 percent of premium or 10 percent of the deficit per account, for a maximum total of 30 percent.³² This assessment can be collected for as many years as is necessary to cure a deficit. Emergency assessments are levied on virtually all property and casualty policies in the state, including Citizens' own policies. However, this assessment is not levied on workers' compensation, medical malpractice, accident and health, crop or federal flood insurance policies. Mechanically, property and casualty insurers with policies subject to the emergency assessment collect the assessment from policyholders at the issuance of a new policy or at renewal of existing policies and then remit the assessments periodically to Citizens. Thus, Citizens will not collect funds raised by an emergency assessment immediately after the assessment is levied but will collect funds intermittently throughout the collection period as policies are renewed and new policies written.

Proposed Changes Relating to Assessments Levied by Citizens

Acknowledgment of Assessment Potential

Starting January 1, 2012, the bill requires insurance agents issuing property insurance in Citizens to obtain an acknowledgement signed by the applicant for insurance relating to the potential assessments imposed on the policy by Citizens. Citizens must keep a copy of the signed acknowledgement. Citizens must provide the same acknowledgement statement to existing Citizens' policyholders when the policy renews with Citizens. Thus, potential and current policyholders of Citizens will be informed about the potential assessments that can be imposed on their policy. The signed acknowledgement creates a conclusive presumption the policyholder understood and accepted the Citizens' assessment liability. However, only new policies issued by Citizens after January 1, 2012 will have a signed acknowledgment because Citizens is only required to provide a copy of the form to renewed policyholders.

Levy of Assessment

Under current law, Citizens collects a Citizens Policyholder Surcharge (surcharge) for 12 months and can only collect the surcharge on new policies issued by Citizens during the 12 month collection period or on current policies renewed by Citizens during the 12 month collection period. Thus, under current law a policyholder insured in Citizens when the Citizens Policyholder Surcharge is levied can avoid paying the surcharge:

1. By canceling the Citizens' policy mid-term during the 12 month collection period and moving to a private company; and
2. By not renewing a Citizens' policy that ends during the 12 month collection period.

³¹ s. 627.351(6)(b)3.a. and b., F.S.

³² s. 627.352(6)(b)3.d., F.S.

In both cases, a policyholder who was insured in Citizens when the Citizens Policyholder Surcharge was levied is not required to pay the surcharge.

The bill prevents the first scenario by requiring Citizens' policyholders to pay the surcharge when their Citizens' policy is cancelled. The second scenario is not addressed by the bill. The bill also requires the surcharge to be paid when a Citizens' policy is terminated or renewed or a new policy is issued within 12 months after a surcharge levy. If the surcharge is levied for less than 12 months, Citizens' policyholders must pay the surcharge during the collection period. Policyholders who are not insured by Citizens on the day of the order levying the surcharge are also responsible for paying the surcharge if they obtain insurance in Citizens during the 12 months after a surcharge levy or during the time the surcharge is collected.

Timing of Regular Assessments

The bill also clarifies current law relating to the timing of Citizens' levy of regular assessments against insurance companies. The bill does not allow Citizens to levy regular assessments against insurance companies until Citizens levies a Citizens Policyholder Surcharge in the maximum statutorily allowed amount against Citizens' policyholders. According to a representative of Citizens, this is consistent with how Citizens currently levies regular assessments.³³

Amount of Emergency Assessments

The bill requires Citizens' policyholders to pay more in emergency assessments than non-Citizens' policyholders. Specifically, Citizens' policyholders will pay 1½ times the emergency assessment non-Citizens' policyholders will pay and the assessment percentage for Citizens' policyholders is increased from 10 percent to 15 percent.

Bad Faith Claims Against Citizens

Bad faith liability is premised on the concept that an insurer that handles a claim should act in good faith towards its insured and "has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business."³⁴ The circumstances giving rise to bad faith claims are found in s. 624.155, F.S. This statute allows anyone to bring a civil action against an insurer when the person is damaged by specified acts or omissions of the insurer. Generally, the acts or omissions leading to a bad faith claim include: not attempting in good faith to settle a claim, making a claims payment without an accompanying statement of coverage relating to the payment, and not settling a claim when the insurer has a reasonably clear obligation to settle the claim in order to influence settlement of other portions of the claim. An insurer must pay damages, court costs, and reasonable attorney fees if the insurer loses a bad faith claim. Punitive damages can be awarded in specific instances.

Citizens has generally been considered to be immune from statutory bad faith liability based upon its sovereign immunity from suit in s. 627.351(6)(s)1., F.S. In 2009, the Fifth District Court of Appeal (DCA) upheld Citizens' immunity from statutory bad faith liability.³⁵ According to the decision, s. 627.351(6)(r), F.S. "... immunizes Citizens from bad faith claims."³⁶ Furthermore, the court held "...Citizens is not subject to bad faith liability under section 624.155(1)(b)(1), as that statute is not applicable to it."³⁷ Additionally, in its decision, the court noted the Citizens' statute creates exemptions

³³ Conversation with a representative of Citizens on March 15, 2011.

³⁴ *Boston Old Colony Ins. Co. v. Gutierrez*, 326 So.2d 783 (Fla. 1980).

³⁵ *Citizens Prop. Ins. Co. v. Garfinkel*, 25 So.3d 62 (Fla. 5th DCA 2009).

³⁶ *Garfinkel*, 25 So.3d at 63. The sovereign immunity statute governing the issue of whether Citizens was liable for bad faith was found in s. 627.351(6)(r), F.S. in 2008. The 2008 statute is the one cited by the court in the *Garfinkel* decision as being applicable to that case. In 2009, paragraphs (f) – (ee) of s. 627.351(6), F.S. were redesignated to paragraphs (g) – (ff) in section 4 of chapter 2009-77, L.O.F. Chapter 2009-77, L.O.F., enacted a new paragraph (f) in s. 627.351(6), F.S., causing this redesignation. Thus, the Citizens' sovereign immunity statute which was contained in paragraph (r) in the 2008 statute was redesignated as paragraph (s) in 2009.

³⁷ *Garfinkel*, 25 So.3d at 67.

from Citizens' grant of immunity, but that an action for bad faith is not one of the exceptions.³⁸ The Fifth DCA upheld Citizens' immunity from bad faith liability again in 2010 based on their 2009 decision.³⁹

The bill specifies that Citizens is not liable for bad faith or extra-contractual damages due to bad faith.

Sinkhole Coverage Offered by Citizens

Since 1981, insurers offering property coverage in Florida, including Citizens, have been required by law to provide coverage for property damage from sinkholes.⁴⁰ In 2007, the sinkhole coverage law was amended to require insurers in Florida to cover only catastrophic ground cover collapse, rather than all sinkhole loss, in the base property insurance policy.⁴¹ However, insurers must also offer policyholders, for an appropriate additional premium, sinkhole loss coverage covering any structure, including personal property contents.⁴² Sinkhole loss coverage includes repairing the home, stabilizing the underlying land, and repairing the foundation.

The number and cost of sinkhole insurance claims have increased substantially over the last several years.⁴³ Like insurers in the private market, Citizens has seen an increase in the number of sinkhole claims filed in recent years. Statewide, the number of sinkhole claims filed on personal residential policies insured by Citizens increased from 660 in 2005 to 1,519 in 2009 and 1,145 in 2010.⁴⁴ The increase in sinkhole claims is the primary cost driver for Citizens' significant sinkhole losses. In 2009, Citizens incurred almost \$84 million in sinkhole losses plus adjustment expenses, yet obtained a little over \$22 million in earned sinkhole premium to cover those losses.⁴⁵

The increase in sinkhole claims has occurred even though significant numbers of Citizens' policyholders dropped sinkhole coverage after it became an optional endorsement in 2007. The percent of Citizens' statewide policies with sinkhole coverage fell from 100 percent in 2006 (when it was mandatory) to 61 percent in 2009 and 60 percent in 2010.⁴⁶ In 2009, only 37 percent of policyholders in Hernando County and 22 percent of policyholders in Pasco County purchased Citizens' policies with sinkhole coverage. In 2010, these percentages increased slightly to 40 percent and 23 percent respectively.⁴⁷

Citizens insured 4,261 claims (36 percent) of the 11,873 sinkhole claims in Hernando, Pasco, and Hillsborough counties reported to the OIR in a data call done by the OIR in 2010.⁴⁸ Citizens' data shows the sinkhole loss ratio for Hernando County in 2009 is 647 percent, meaning for every \$1 in premium Citizens collects in Hernando County, \$6.47 is paid for a sinkhole claim in the county.

³⁸ *Garfinkel*, 25 So.3d at 64-66.

³⁹ *Citizens Prop. Ins. Co. v. La Mer Condominium Ass'n, Inc.*, 37 So.3d 988 (Fla. 5th DCA). Although in 2010, the First District Court of Appeal declined to grant a writ of prohibition requested by Citizens on the trial court's denial of Citizens' motion to dismiss a suit filed against Citizens alleging bad faith, the court did not decide the merits of whether Citizens was subject to bad faith liability. However, the First DCA certified conflict with the Fifth DCA's decisions in *Garfinkel and La Mer Condominium Ass'n* which held Citizens was entitled to a writ of prohibition under similar circumstances. The First DCA also certified a question of great public importance to the Florida Supreme Court about the time for appellate review of a trial court's denial of a motion to dismiss based upon a claim of sovereign immunity. (*See Citizens Prop. Ins. v. San Perdido Ass'n Inc.*, 46 So.3d 1051 (Fla. 1st DCA 2010)). The Florida Supreme Court accepted jurisdiction of the case and the case is currently pending in the Supreme Court (*See Citizens Prop. Ins. Co. v. San Perdido Ass'n, Inc., No. SC10-2433*). In its initial brief, Citizens argues the merits of subjecting the corporation to bad faith liability and the appropriate appellate review process for sovereign immunity issues.

⁴⁰ Ch. 1981-280, L.O.F.

⁴¹ Section 30, Ch. 2007-1, L.O.F.

⁴² s. 627.706, F.S.

⁴³ The increase in claims frequency and severity is based on data collected from 211 insurers, including Citizens, by the Office of Insurance Regulation (OIR) in the Fall of 2010, (*Report on Review of the 2010 Sinkhole Data Call* (OIR Report)).

⁴⁴ Information received from Citizens on March 2, 2011, on file with the Insurance & Banking subcommittee. In 2009, Citizens received 118 sinkhole claims on commercial residential and commercial non-residential policies located outside the wind zones and in 2010 received 57 claims on these policies.

⁴⁵ Information received from Citizens on March 2, 2011, on file with the Insurance & Banking subcommittee.

⁴⁶ Information received from Citizens on March 2, 2011, on file with the Insurance & Banking subcommittee.

⁴⁷ Information received from Citizens on March 2, 2011, on file with the Insurance & Banking subcommittee.

⁴⁸ *Report on Review of the 2010 Sinkhole Data Call* by the Office of Insurance Regulation, pg 12.

Citizens' 2009 loss ratio is almost 285 percent in Pasco County and is almost 526 percent in Hillsborough County. The loss ratio for all other counties combined is 175 percent.⁴⁹

The bill prohibits policies issued by Citizens on or after January 1, 2012 covering sinkhole loss to cover losses to appurtenant structures, driveways, sidewalks decks, or patios directly or indirectly caused by sinkholes.

B. SECTION DIRECTORY:

Section 1: Amends s. 627.351, F.S., relating to Citizens Property Insurance Corporation.

Section 2: Amends s. 627.712, F.S., relating to residential windstorm coverage required to correct cross-references to s. 627.351, F.S.

Section 3: Provides the bill is effective upon becoming a law.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Taken as a whole, the changes made by the bill should reduce the number of policies in Citizens. Reducing the number of policies in Citizens decreases the amount of losses experienced by Citizens. Decreasing the amount of losses lessens the likelihood of a deficit for Citizens, which in turn, reduces the probability and amount of assessments on Citizens' and non-Citizens' policyholders.

Impact of Changing the Eligibility for Insurance in Citizens

Further restricting eligibility for insurance in Citizens, either by premium comparison or by the insured value of the property, will force some Citizens' policyholders into the private or surplus lines market for property insurance. These markets could charge more for insurance than Citizens which would increase the premiums for some Citizens' policyholders.

According to Citizens, since October 1, 2009, Citizens has insured over 78,000 policies (18 percent of the personal residential multiperil policies written since October 1, 2009) because the premium charged for the policy by a private market insurer is more than 15 percent than the premium charged by Citizens for comparable coverage. Citizens does not collect this data for commercial residential property, so an analogous statistic is not available for this type of property insured by Citizens.

⁴⁹ Information received from Citizens on March 2, 2011, on file with the Insurance & Banking subcommittee.

Impact of Changing Eligibility Based on Insured Value

As of December 31, 2010, Citizens writes almost 5,000 policies in the personal lines account with an insured value of over \$500,000. Starting January 1, 2016, these policies will no longer obtain coverage in Citizens (after the phase out period in the bill fully takes effect).⁵⁰

As of December 31, 2010, Citizens writes around 6,500 policies with an insured value of from \$1 million to \$2 million in the high risk account. Starting January 1, 2012, these policies will no longer obtain coverage in Citizens. Citizens writes over 22,000 policies with an insured value of over \$500,000 in the high risk account. Starting January 1, 2016, these policies will no longer obtain coverage in Citizens (after the phase out period in the bill fully takes effect).

Starting January 1, 2016, the total effect of the changes in the bill restricting the eligibility based on insured value is a reduction of about 33,500 Citizens' policies.

Impact of Changing Flood Insurance Requirement

Requiring some Citizens' policyholders to purchase flood insurance means increased out-of-pocket expenses for these policyholders, if the policyholder does not currently purchase flood insurance. However, the policyholders will be paid by the insurer for property damage caused by flooding which means less out-of-pocket expenses when there is damage.

Impact of Allowing Surplus Lines Insurers to Depopulate Citizens

Allowing surplus lines insurers to take policies out of Citizens will reduce the number of policies in Citizens.

Citizens' policyholders who accept an offer of coverage from a surplus lines insurer will not be able to have their property insurance claims paid for by the Florida Insurance Guaranty Association if the surplus lines insurer becomes insolvent. Policyholders who accept coverage from a surplus lines insurer will not be subject to the Citizens' Policyholder Surcharge, if one is levied.

Impact of Changing the Coverage Provided by Citizens for Screen Enclosures

Because Citizens will not cover screen enclosures starting January 1, 2012, policyholders with screen enclosures will no longer be paid for damage to the enclosures. However, the policyholder's rate and premium should decrease due to damage to screen enclosures being excluded in the policy.

Citizens cannot quantify the number of screen enclosures the corporation currently insures as enclosures are included in the base property insurance policy in the coverage for Coverage A⁵¹ or Coverage B⁵² and are not covered by an endorsement.

If excluding coverage for screen enclosures reduces Citizens' exposure, expected losses should also decrease. This decrease reduces the likelihood and amount of assessments on Citizens' and non-Citizens' policyholders.

Impact of Changing the Rates Charged by Citizens

Because the bill increases the rate caps for Citizens' policies, Citizens' policyholders will have larger rate increases than under current law, with maximum rate increases of 15 percent a year per policy, instead of 10 percent a year per policy.

Rates and premiums for an individual Citizens' policyholder could increase more than the rate cap if the policyholder chooses to purchase sinkhole loss coverage for an additional premium. The increase will be the amount commensurate with the sinkhole risk Citizens is insuring and will be actuarially determined.

⁵⁰ All information on the number of policies written by Citizens based on insured value was received from Citizens and is on file with the Insurance & Banking Subcommittee. 791 policies are insured for over \$750,000 and would not be eligible for Citizens' coverage starting January 1, 2014. 4,156 policies are insured for \$500,001 to \$750,000 and would not be eligible for Citizens' coverage starting January 1, 2016.

⁵¹ Coverage A is the coverage on the building or dwelling.

⁵² Coverage B is the coverage on other structures on the property (e.g., shed, detached garage).

Rates and resulting premiums for all Citizens' policyholders could increase more than the rate cap if Citizens' buys reinsurance and the cost of that purchase justifies a rate increase more than the cap.

Impact of Changing the Collection of Citizens Policyholder Surcharges

Some Citizens' policyholders that can avoid paying the Citizens Policyholder Surcharge under current law will no longer be able to avoid the surcharge and will have to pay the surcharge if Citizens incurs a deficit during the policy term. This should result in Citizens collecting more money via a Citizens Policyholder Surcharge which, in turn, reduces the likelihood and amount of regular and emergency assessments.

Impact of Changing the Amount of Emergency Assessments

Increasing the emergency assessment against Citizens' policyholders requires Citizens' policyholders to pay more for emergency assessments than under current law. Furthermore, the maximum amount of an emergency assessment that can be levied against Citizens' policyholders is increased from 10 percent to 15 percent.

Impact of Changing the Sinkhole Coverage Offered by Citizens

Prohibiting Citizens' sinkhole coverage from covering losses to appurtenant structures, driveways, sidewalks decks, or patios should reduce Citizens' sinkhole exposure so expected losses should also decrease. This decrease reduces the likelihood and amount of assessments on Citizens' and non-Citizens' policyholders. The decrease may also reduce rates and premiums.

Impact of Clarifying Bad Faith Exemption for Citizens

If the bill's clarification on the application of the bad faith law to Citizens reduces the number of or eliminates bad faith suits filed against Citizens, Citizens will see reduced legal fees associated with defending these suits and should not incur future legal fees to defend such suits.

D. FISCAL COMMENTS:

The bill does not specify who pays for the outsourcing cost-benefit study required for Citizens' policy issuance and service functions. Thus, it is assumed Citizens will pay for this study.

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:

Conclusive Presumptions

A statutory presumption is conclusive if it prevents a party from proving or disproving the presumed fact. Conclusive presumptions can raise constitutional due process concerns but are permissible in some circumstances. The constitutionality of a conclusive presumption under the due process clause is measured by determining:

- 1) Whether the concern of the Legislature was reasonably aroused by the possibility of an abuse which it legitimately desired to avoid;
- 2) Whether there was a reasonable basis for a conclusion that the statute would protect against its occurrence; and

- 3) Whether the expense and other difficulties of individual determinations justify the inherent imprecision of a conclusive presumption.⁵³

Florida insurance statutes contain conclusive presumptions related to selection or rejection of homeowner's law and ordinance coverage,⁵⁴ a motor vehicle insurance policyholder's election to purchase uninsured motorist coverage at lower limits than the insured's bodily injury coverage,⁵⁵ the assessment liability of the policyholders of a worker's compensation self insurance fund,⁵⁶ informed consent of HIV and AIDS testing for insurance purposes,⁵⁷ and the possibility that a Citizens Property Insurance Corporation policy could be replaced by a policy from an authorized insurer that does not provide identical coverage.⁵⁸ The bill provides a signed acknowledgement form by a Citizens' policyholder about the assessable nature of the Citizens' policy creates a conclusive presumption a Citizens' policyholder understood and accepted their liability for a surcharge or assessment levied by Citizens.

B. RULE-MAKING AUTHORITY:

None provided in the bill and none repealed by the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On March 30, 2011, the Insurance & Banking Subcommittee heard a Proposed Committee Substitute, adopted three amendments to the Proposed Committee Substitute, and reported the Proposed Committee Substitute favorably. The amendments adopted allowed surplus lines insurers meeting specified requirements to take out policies from Citizens, with OIR approval for the take out. The amendments also allowed Citizens to release underwriting files and confidential claims files to insurers who take out policies from Citizens, as long as the insurer agrees to maintain the confidentiality of the files.

The staff analysis was updated to reflect adoption of the Proposed Committee Substitute.

On April 7, 2011, the Economic Affairs Committee heard the bill, adopted one amendment, and reported the bill favorably with a Committee Substitute. The amendment reduced the rate increase for Citizens to 15 percent per policyholder per year, rather than 20 percent per rating territory and 25 percent per policyholder as the bill provided.

The staff analysis was updated to reflect the Committee Substitute.

⁵³ Hall v. Recchi America, Inc., 671 So.2d 197, 200 (Fla 1st DCA 1996).

⁵⁴ s. 627.7011(2), F.S.

⁵⁵ s. 627.727(1), F.S.

⁵⁶ s. 440.585, F.S.

⁵⁷ s. 627.429, F.S.

⁵⁸ s. 627.351(6)(c)11., F.S.