

**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 Budget Committee

BILL: CS/SB 1714

INTRODUCER: Banking and Insurance Committee and Senator Hays

SUBJECT: Citizens Property Insurance Corporation

DATE: April 11, 2011 REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Knudson</u>	<u>Burgess</u>	<u>BI</u>	<b>Fav/CS</b>
2.	<u>Frederick</u>	<u>Meyer, C.</u>	<u>BC</u>	<b>Pre-meeting</b>
3.	_____	_____	<u>RC</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**Please see Section VIII. for Additional Information:**

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|------------------------------|-------------------------------------|-----------------------------------------|
| A. COMMITTEE SUBSTITUTE..... | <input checked="" type="checkbox"/> | Statement of Substantial Changes        |
| B. AMENDMENTS.....           | <input type="checkbox"/>            | Technical amendments were recommended   |
|                              | <input type="checkbox"/>            | Amendments were recommended             |
|                              | <input type="checkbox"/>            | Significant amendments were recommended |

**I. Summary:**

This bill makes the following changes relating to Citizens Property Insurance Corporation (Citizens), the not-for-profit, tax-exempt governmental entity that provides property insurance coverage to those unable to find coverage in the voluntary admitted market in Florida.

**Eligibility Requirements**

- Applicants for Citizens personal lines residential (homeowners) coverage or commercial lines residential coverage are ineligible to obtain such coverage if the premium for coverage from an authorized insurer is within 25 percent of the Citizens premium. As of January 1, 2015, such applicants are ineligible for Citizens coverage upon receiving an offer of private market coverage at any approved rate.
- As of 2012, all structures with a replacement value of \$1 million or more are ineligible for Citizens.
- As of 2014, residential structures in the Personal Lines Account with a replacement value of \$750,000 or more are ineligible for coverage.
- As of 2016, residential structures in the Personal Lines Account with a replacement value of \$500,000 or more are ineligible for coverage.

- A Citizens applicant or policyholder must maintain a separate flood insurance policy that has coverage limits for the building and contents equal to those provided under the Corporations' policy, subject to the maximum limits available under the National Flood Insurance Program if the property is located in a Special Flood Hazard Area as defined by the National Flood Insurance Program (NFIP).
- Citizens must cease issuing new commercial nonresidential insurance policies.
- Structures that obtain a construction permit on or after June 1, 2011, that are located seaward of the coastal construction control line shall be ineligible for Citizens coverage.

### **Citizens Rates**

- Citizens must implement a rate increase of up to 20 percent by territory and 25 percent for any single policy each year for each residential line of business it writes. The mandatory rate increase expires January 1, 2015. The limitation on rate increases does not apply to sinkhole coverage or costs incurred through the purchase of private reinsurance.
- Citizens must develop its rates using an industry expense equalization factor.
- Citizens is prohibited from reducing rates.
- Citizens may impose a premium surcharge on residential structures located within the wind-borne debris region that do not have opening protections.

### **Citizens Coverage**

- Citizens may not offer or renew HO-3 homeowners policies as of December 31, 2012. Instead, Citizens must offer a policy similar to what is available in the private insurance market under an HO-3 (homeowners), HO-4 (renters), or HO-6 (condominium) policy.
- Citizens must offer sinkhole coverage. Policies covering sinkhole that are effective on or after February 1, 2012, will not provide coverage to appurtenant structures.
- Payments for sinkhole loss tendered by Citizens must be dedicated entirely to repairing the structure or remediating of the land.
- Citizens policies issued or renewed on or after February 1, 2012, will not cover screened enclosures.
- Citizens policies issued or renewed on or after February 1, 2013, will not cover detached structures.
- Citizens policies issued or renewed on or after February 1, 2013, will not cover specified items of personal property.

### **Citizens Surcharges and Assessments**

- Citizens must levy the full amount of the Citizens policyholder surcharge before levying a regular assessment.
- Citizens policyholders must pay emergency assessments that are 1.5 times the emergency assessment levied on insureds in the private insurance market.
- As of January 1, 2012, an agent seeking to place coverage with Citizens must obtain the applicant's signature on a written disclosure of liability to surcharges and assessments.

### **Public Adjusters**

- Prohibits policyholders from engaging the services of a public adjuster with respect to any claim incurred under a policy issued by Citizens until the policyholder has received an offer on the claim from Citizens.
- Limits public adjuster compensation on Citizens claims to a reasonably hourly rate, not to exceed 5 percent of the additional amount secured by the policyholder in excess of the Citizens offer.

### **Other Provisions**

- Clarifies existing law that Citizens is not subject to bad faith liability.
- Exempts Citizens from liability to pay attorney's fees pursuant to s. 627.428, F.S.
- Deletes requirements that Citizens reduce the boundaries of the high-risk area.
- Discontinues the statutory authorization for insurers to provide multi-policy discounts when a homeowner's policy is insured by Citizens or taken out from Citizens by a different insurer.
- Authorizes eligible surplus lines carriers to take part in any depopulation, take-out, or keep-out program adopted by Citizens.
- Citizens must enact recommendations by an independent third-party consultant on the relative costs and benefits of outsourcing Citizens policy issuance and service functions to private servicing carriers or similar entities.
- Repeals the Citizens quota-share insurance program.
- Provides conflict of interest procedures for Citizens board members.

The bill is effective upon becoming a law.

This bill substantially amends the following sections of the Florida Statutes: 627.0655, 627.351(6), and 627.3511(4).

## **II. Present Situation:**

### **Citizens Property Insurance Corporation**

Citizens Property Insurance Corporation (Citizens) is a state-created, not-for-profit, tax-exempt entity whose public purpose is to provide property insurance coverage to those unable to find affordable coverage in the voluntary admitted market.<sup>1</sup> It is a governmental entity and not a private insurance company.<sup>2</sup> Created in 2002 by the Florida Legislature, Citizens combined the state's two insurers of last resort, the Florida Residential Property and Casualty Joint Underwriting Association (RPCJUA) and the Florida Windstorm Underwriting Association (FWUA). The merger allowed Citizens to become exempt from federal income taxes, resulting in millions of dollars in annual savings, as well as additional administrative and economic efficiencies.

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<sup>1</sup> Admitted market means insurance companies licensed to transact insurance in Florida.

<sup>2</sup> Section 627.351(6)(a)1., F.S. Citizens is also subject to regulation by the Office of Insurance Regulation.

Citizens operates under the direction of an 8-member Board of Governors<sup>3</sup> and offers three types of property and casualty insurance in three separate accounts. Each account is a separate statutory account with separate calculations of surplus and deficits.<sup>4</sup> Assets may not be commingled or used to fund losses in another account.<sup>5</sup> In its most recent monthly report,<sup>6</sup> Citizens reported the following data as of February 28, 2011:

- **Personal Lines Account (PLA)**: Statewide account offering multiperil policies covering homeowners, mobile homeowners, dwelling fire, tenants, condominium unit owners, and similar policies.
  - 854,701 Policies in Force
  - \$194,695,466,632 Total Exposure
  - \$1,330,029,554 In Force Premium
- **Commercial Lines Account (CLA)**: Statewide account offering multiperil policies covering commercial residential-condominium associations, apartment buildings and homeowners associations; and commercial non-residential policies.
  - 8,377 Policies in Force
  - \$42,309,533,919 Total Exposure
  - \$213,883,613 In Force Premium
- **High-Risk Account (HRA)**: Coastal area account offering personal residential wind-only policies, commercial residential wind-only policies and commercial non-residential wind-only policies issued in limited eligible coastal areas. In addition, in August of 2007, Citizens began offering personal and commercial residential multiperil policies in the HRA.
  - 445,779 Policies in Force
  - \$229,169,417,342 Total Exposure
  - \$1,141,058,109 In Force Premium
- **Total All Accounts Combined**:
  - 1,308,857 Policies in Force
  - \$466,174,417,893 Total Exposure
  - \$2,684,971,276 In Force Premium

Citizens financial resources include insurance premiums, investment income, operating surplus from prior years, Florida Hurricane Catastrophe Fund (FHCF) reimbursements, its policyholder surcharges, and regular and emergency assessments. With the estimated income from 2011, Citizens will have an accumulated surplus of approximately \$5.4 billion. Citizens has approximately \$6.3 billion in mandatory layer reinsurance from the FHCF. Citizens has additional pre-event liquidity of \$2.9 billion. Aggregately, for 2011 Citizens has a claims paying capacity of \$14.672 billion.

Citizens' probable maximum loss (PML) from a 1-in-100 year event is \$22.2 billion. In the event Citizens incurs a deficit (i.e. its obligations to pay claims exceed its capital plus reinsurance

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<sup>3</sup> The Governor, the Chief Financial Officer, the President of the Senate and the Speaker of the House of Representatives appoint two members each.

<sup>4</sup> The Personal Lines Account and the Commercial Lines account are combined for credit and Florida Hurricane Catastrophe Fund coverage.

<sup>5</sup> Section 627.351(6)(b)2b., F.S

<sup>6</sup> See <https://www.citizensfla.com/about/corpfinitials.cfm>; last visited March 26, 2011.

recoveries), it may levy regular assessments on most of Florida's property and casualty insurance policyholders in a specific sequence set by statute as follows:<sup>7</sup>

- Require up to a 15 percent of premium surcharge for 12 months on all Citizens' policies, collected upon issuance or renewal. This 15 percent assessment can be levied on each of the three Citizens' accounts with a maximum assessment of 45 percent of premium.
- If the Citizens' surcharge is insufficient to cure the deficit for any individual account, Citizens can require an assessment against insurers (which may be recouped from their policyholders through a rate filing process) of up to 6 percent of premium for most lines of property and casualty insurance, or 6 percent of the deficit, whichever is greater. This assessment may also be levied per account for a maximum total assessment of 18 percent; however, this assessment is not levied against Citizens' policyholders.
- Require any remaining deficit to be funded by multi-year emergency assessments on policyholders on most types of property and casualty insurance, including Citizens' policies, of up to 10 percent of premium for most lines of property and casualty insurance, or 10 percent of the deficit, whichever is greater. This assessment may be levied per account for a total maximum assessment of 30 percent per policy.

### **Citizens Rates**

Until 2010, Citizens rates had been frozen by statute<sup>8</sup> at the level that had been established in 2006. In 2010, the Legislature established a "glide path" to impose annual rate increases up to a level that is actuarially sound.<sup>9</sup> Citizens must implement an annual rate increase which does not exceed 10 percent above the previous year for any individual policyholder, adjusted for coverage changes and surcharges. The implementation of this increase ceases when Citizens has achieved actuarially sound rates. In addition to the overall glide path rate increase, Citizens can increase its rates to recover the additional reimbursement premium that it incurs as a result of the annual cash build-up factor added to the price of the mandatory layer of the FHCF coverage, pursuant to s. 215.555(5)(b), F.S.

### **Citizens Sinkhole Experience**

Insurers, including Citizens, offering property insurance to homeowners in Florida have been required to offer coverage for damages resulting from sinkholes since 1981.<sup>10</sup> Under current law, insurers must make available to policyholders, for an appropriate additional premium, sinkhole coverage for losses on any structure, including personal property contents. Sinkhole coverage includes repairing the home, stabilizing the underlying land, and foundation repairs. Property insurers must also provide coverage for catastrophic ground cover collapse.<sup>11</sup> According to a data call issued by the Office of Insurance Regulation (OIR) in 2010, 66 percent of Florida's sinkhole claims were filed in three counties, Hernando, Pasco and Hillsborough.

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<sup>7</sup> Section 627.351(6)(b)3.a.,d., and i., F.S.

<sup>8</sup> Section 627.351(6)(n)4., F.S.

<sup>9</sup> Ch. 2009-87; s.10, L.O.F.

<sup>10</sup> Ch. 81-280, L.O.F.

<sup>11</sup> Catastrophic ground cover collapse refers to damage from an abrupt ground collapse for which the property is condemned.

The largest writer of sinkhole coverage in Florida is Citizens, and its market share of the sinkhole coverage is even higher in the three counties of greatest activity (Hernando, Pasco and Hillsborough). The rate that Citizens is authorized to charge for sinkhole coverage is far below that which would be necessary to cover the sinkhole losses it incurs, particularly in Hernando, Pasco and Hillsborough. Some examples of Citizens' sinkhole rate deficiency are as follows: In 2009, sinkhole losses<sup>12</sup> from Hernando were almost seven times the premium that was collected to cover those losses. The total premium in Hernando to cover sinkhole losses was \$5.9 million, but the losses in Hernando were \$40.5 million.

In fact, sinkhole losses from Hernando alone were nearly twice the amount of the entire statewide premium. The total premium collected statewide for the sinkhole endorsement in 2009 was \$22.2 million, while in Hernando sinkholes losses were \$40.5 million. Pure premium is the term used to describe the amount that all policyholders with the sinkhole endorsement would need to pay to cover the sinkhole losses (with no profit or indirect costs added). The statewide sinkhole pure premium was \$295, while the sinkhole premium that Citizens was allowed to collect to cover sinkholes averaged only \$73. The pure premium for Hernando sinkhole losses was \$5,300, but the average premium was only \$775 for this coverage.

The high cost of sinkhole losses is a result the combination of the two primary components of total losses: claims frequency and claims severity. Claims frequency is commonly measured as a percentage: the ratio of the number of claims compared to the number of policyholders in a given period. Citizens' statewide claims frequency more than doubled from two-tenths of a percent in 2005 to almost one-half percent in 2009. In Hernando, Citizens' claims frequency in 2009 was six times what it was in 2005, going from approximately one percent in 2005 to almost seven percent in 2009. This means that for every 100 policyholders purchasing coverage in 2009, seven policyholders filed a claim.

The extraordinary rise in the claims frequency ratio resulted from the fact that the actual number of claims continues to rise, even while the number of policyholders selecting to purchase the coverage is declining. Sinkhole coverage became an optional endorsement in 2007 (although ground cover collapse remains a mandatory coverage), and a significant number of policyholders began to drop the sinkhole coverage. As a result of this substantial reduction in the number of people choosing to pay for sinkhole coverage, the problems of the increasing number of claims is magnified by the fact that there are fewer policyholders (and therefore less total collected premium) over which to spread the increasing losses. Citizens data shows:

- The percent of Citizens' statewide policies with sinkhole coverage fell from 100 percent in 2006 (when it was mandatory) to 61 percent in 2009.
- In Hernando County, the percent of Citizens' policies with sinkhole coverage fell from 100 percent in 2006 to 37 percent in 2009.
- In Pasco County, the percent of Citizens' policies with sinkhole coverage fell from 100 percent in 2006 to 22 percent 2009.

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<sup>12</sup> As used here, "losses" refers to indemnity costs for both open and closed claims, plus loss adjustment expenses (LAE). A loss adjustment expense (LAE) is the direct cost associated with investigating, administering, defending, or paying an insurance claim.

Notwithstanding the substantial reduction in the number of policyholders choosing sinkhole coverage, there has still been a rise in the number of sinkhole claims being filed. Citizens' data shows:

- Statewide, the number of sinkhole claims more than doubled between 2005 and 2009, rising from 660 in 2005 to 1404 in 2009.
- In Hernando County, the number of sinkhole claims more than quadrupled, rising from 113 in 2005 to 520 in 2009.

The other primary component driving the sinkhole losses is the average claim severity. The average severity is the average amount of cost that Citizens incurred (indemnity plus LAE) for all claims for which a payment was made. Citizens' average annual claim severity between 2005 and 2009 averaged \$130,191, with a range from \$91,717 (2009) to \$155,286 (2007). In 2005, the average claim severity actually exceeded the average coverage limit for the structure.

### **Bad Faith Claims**

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."<sup>13</sup> Florida recognizes two bad faith causes of actions against insurers: first party bad faith and third party bad faith. Florida first recognized Third-party bad faith at common law in 1938.<sup>14</sup> Third-party bad faith protects an insured from the insurer failing to settle a claim brought by a third party in good faith and exposing the insured to a judgment in excess of policy limits. Florida courts refused to recognize a first-party bad faith tort until it was established by the Legislature in 1982 with the enactment of section 624.155, Florida Statutes, the Civil Remedy statute.

Section 624.155, Florida Statutes permits any person to bring a civil action against an insurer when the insurer commits certain acts or the insured is damaged by statutory violations<sup>15</sup> of the insurer. Specifically, the insurer may bring the claim when the insurer does not attempt to settle a claim in good faith when, under all the circumstances, it could and should have done so, had it acted fairly and honestly toward the insured and with due regard to the interests of the insured. A claim may also be brought if the insurer makes claims payments without identifying the coverage under which the payment is made or attempts to influence settlements under one portion of the insurance policy by refusing to promptly resolve a claim it should settle under another portion of the policy.

The insurer is not liable for bad faith liability until the Plaintiff obtains an adjudication in its favor at trial or on appeal, at which point insurer liability for bad faith, costs and reasonable attorney's fees attaches. The insured must prove that the insurer committed bad faith in order to obtain recovery. In order to bring an action under s. 624.155, F.S., the Plaintiff must provide the authorized insurer and the Department of Financial Services 60-days written notice of the violation. The notice must detail the statutory provisions the insurer is alleged to have violated,

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<sup>13</sup> *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So.2d 783 (Fla. 1980)

<sup>14</sup> See *Auto. Mut. Indem. Co. v. Shaw*, 134 Fla. 815, 184 So. 852 (1938).

<sup>15</sup> Violations giving rise to a statutory bad faith claim are s. 626.9541(1)(i), (o), or (x), F.S.; s. 626.9551, F.S.; s. 626.9705, F.S.; s. 626.9706, F.S.; s. 626.9707, F.S.; or s. 627.7283, F.S.

the facts and circumstances giving rise to the violation, reference to insurance policy language relevant to the violation. No action for bad faith may be brought if the insurer pays the requested damages or corrects the circumstances giving rise to the violation within 60 days.

Citizens Property Insurance Corporation 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. The courts have noted that the statute creates exemptions from Citizens' grant of immunity, but that an action for bad faith is not one of the exceptions.<sup>16</sup> However, a recent decision of the First District Court of Appeals refused to reverse a trial court determination that Citizens is subject to bad faith liability based on the exceptions to Citizens' immunity for willful torts and a breach of the insurance contract.<sup>17</sup>

### **Surplus Lines Insurance Coverage – Background**

Insurance companies that transact insurance in Florida or that have offices located in the state are required to obtain a certificate of authority (COA) issued by the Office of Insurance Regulation (OIR) pursuant to s. 624.401, F.S. These companies, referred to as authorized or admitted insurers,<sup>18</sup> are broadly regulated by the OIR under the Insurance Code as to reserves, surplus as to policyholders, solvency, rates and forms, market conduct, permissible investments, and affiliate relationships.<sup>19</sup> Authorized insurers are also required to participate in a variety of government mandated insurance programs and pay assessments levied by state guaranty funds in the event of insurer insolvencies.<sup>20</sup>

Surplus lines insurers are regulated by the state, but do not have to obtain a COA and are not required to adhere to the other requirements mentioned above. Surplus lines insurance is an alternative type of insurance coverage for consumers to buy property-liability insurance from unauthorized (non-admitted) insurers when consumers are unable to purchase the coverage they need from admitted insurers. Surplus lines insurance is coverage provided by a company that is not licensed in Florida, but is allowed to transact insurance in the state as an "eligible" insurer<sup>21</sup> under the surplus lines law (ss. 626.913-626.937, F.S.). Under this law, insurance may only be purchased from a surplus lines carrier if the necessary amount of coverage cannot be procured after a diligent effort to buy the coverage from authorized insurers.<sup>22</sup> Rates charged by a surplus lines carrier must not be lower than the rate applicable and in use by the majority of the authorized insurers writing similar coverages on similar risks in Florida.<sup>23</sup> Likewise, a surplus

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<sup>16</sup> *Citizens Prop. Ins. Co. v. Garfinkel*, 25 So.3d 62 (Fla. 5<sup>th</sup> DCA 2009).

<sup>17</sup> *Citizens Prop. Ins. Co. v. San Perdido Ass'n, Inc.*, 46 So.3d 1051 (Fla 1<sup>st</sup> DCA 2010).

<sup>18</sup> An "authorized" or "admitted" insurer is one duly authorized by a COA to transact insurance in this state.

<sup>19</sup> The Insurance Code consists of chs. 624-632, 634, 635, 636, 641, 642, 648, and 651, F.S.

<sup>20</sup> For example, Florida licensed direct writers of property and casualty insurance must be members of the Florida Insurance Guaranty Association, which handles the claims of insolvent insurers under part II of ch. 631, F.S., and insurers offering workers' compensation coverage in Florida must be members of the Florida Workers' Compensation Insurance Guaranty Association, which provides payment of covered claims for insurers that are declared insolvent under part V of ch. 631, F.S.

<sup>21</sup> An "eligible surplus lines insurer" as defined in s. 626.914(2), F.S., is an "unauthorized insurer" which has been made eligible by the Office of Insurance Regulation to issue insurance coverage under the surplus lines law.

<sup>22</sup> See s. 626.914(4), F.S. A "diligent effort" is defined as seeking coverage from and being rejected by at least three authorized insurers that write the type of coverage being sought. The rejections must be documented.

<sup>23</sup> Section 626.916(1)(b), F.S.



lines policy contract form must not be more favorable to the insured as to the coverage or rate offered by the majority of authorized carriers.<sup>24</sup>

The surplus lines law contains specific financial and other requirements that unauthorized insurers must comply with in order to become eligible surplus lines insurers and obtain approval by the OIR. For example, a surplus lines insurer must maintain a surplus as to policyholders of not less than \$15 million and have been licensed in its state or country of domicile for at least three years.<sup>25</sup>

Historically, surplus lines insurers have never been held subject to Florida's regulation of rates, forms, or other requirements under ch. 627, F.S., as are admitted insurers.<sup>26</sup> This is true of the regulatory treatment of surplus lines insurers in other states across the country. The different regulatory treatment is due to the unique nature of surplus lines insurance because it covers consumer needs arising from emerging technologies, new business practices, or changing legal environments which require a quick response that is often difficult for admitted insurers to provide, according to representatives with the Florida Surplus Lines Office.

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

This bill amends s. 627.0655, F.S., to eliminate the ability of insurers to offer a multi-line insurance discounts for insurance policies placed with Citizens or a "take out" policy from Citizens that is assumed by a different carrier. The current authority to offer multi-line discounts on Citizens policies and "take out" policies serviced by the same agent will be unavailable for policies issued or renewed after January 1, 2013. The change is intended to create an additional incentive for private market insurers to write property insurance and for agents to attempt to place property insurance with private market carriers.

The bill amends s. 627.351(6), F.S., governing Citizens Property Insurance Corporation, in the following areas.

#### **Revision of Legislative Intent Language**

The bill revises Citizens intent language primarily by deleting language that the Legislature intends for Citizens to provide affordable coverage.

#### **Citizens Eligibility – Prohibitions on Higher Value Structures**

Citizens will cease writing coverage for:

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<sup>24</sup> Section 626.916(1)(c), F.S.

<sup>25</sup> Section 626.918, F.S.

<sup>26</sup> See *Affidavits In Support of Intervenor-Plaintiff Essex Insurance Company's Amended Motion for Summary Judgment* by Steve Parton, Office of Insurance Regulation, General Counsel, and Belinda Miller, Office of Insurance Regulation, Deputy Commissioner for Property and Casualty Insurance, filed in *Howard v. Choice Hotels International, Inc.*, Case No. CA06-680-55 (Fla. 7th Cir. Tr. Ct. 2008).

- Structures with a dwelling replacement cost of \$1 million or more or a single condominium unit with a combined dwelling and contents replacement cost of \$1 million or more on January 1, 2012.
- Structures in the personal lines account with a dwelling replacement cost of \$750,000 or more or a single condominium unit with a combined dwelling and contents replacement cost of \$750,000 or more on January 1, 2014.
- Structures in the personal lines account with a dwelling replacement cost of \$500,000 or more or a single condominium unit with a combined dwelling and contents replacement cost of \$500,000 or more on January 1, 2016.

Essentially, the bill creates a two-tiered prohibition on Citizens coverage. As of 2012, all structures with a replacement value of \$1 million or more will be ineligible for Citizens, while residential structures in the Personal Lines Account will have more stringent prohibitions beginning in 2014. A risk that becomes ineligible for Citizens coverage but is insured by a Citizens policy will continue to be insured through the end of the policy term. For instance, if a structure is valued at \$1 million and has a Citizens policy that terminates June 1, 2012, will continue to be insured by Citizens for the full term of the policy, but will not be renewed.

#### **Citizens Eligibility – Offers of Coverage from Authorized Private Market Insurers**

The bill revises the eligibility criteria for obtaining a Citizens policy for personal lines residential risks and commercial lines residential risks. For personal lines residential policies (homeowners), if the new policy will be effective before January 1, 2015, the applicant is ineligible to obtain such coverage from Citizens if the premium for coverage from an authorized insurer is within 25 percent of the Citizens premium. For example, if a consumer applies for coverage with Citizens and the Citizens premium is \$1,000, the policyholder is eligible for Citizens coverage only if the applicant cannot obtain private market insurance for at a premium of \$1,250 or less. For new policies effective on January 1, 2015, and thereafter, a risk is ineligible for Citizens coverage if it has an offer of coverage that includes wind coverage from a private market insurer at the insurer's approved rate.

For commercial lines residential policies, if the new policy will be effective before January 1, 2015, the applicant is ineligible to obtain such coverage from Citizens if the premium for coverage from an authorized insurer is within 25 percent of the Citizens premium. A renewal policy is not eligible for citizens if it has a private market offer of coverage, including wind, at the private market insurer's approved rate.

#### **Citizens Eligibility – Offers of Coverage from Surplus Lines Insurers**

The bill requires Citizens to issue policies that make a policyholder ineligible for Citizens coverage upon receipt of an offer of coverage from a surplus lines insurer. Under current law, if an authorized private-market insurer offers to cover a risk insured by Citizens at the insurer's approved rates, the risk is not eligible for Citizens except as otherwise provided in the Citizens statute. Under the bill, current Citizens policyholder and new Citizens applicants are ineligible for Citizens coverage upon receipt of an offer of coverage from an authorized insurer that does not exceed the Citizens premium by more than 25 percent.

The bill also authorizes eligible surplus lines carriers to take part in any depopulation, take-out, or keep-out program adopted by Citizens. To qualify for participation, the surplus lines carrier must obtain approval from the OIR for its depopulation, take-out, or keep-out plan and comply with Citizens for all Citizens requirements that are applicable to admitted insurers. The OIR must also determine that the surplus lines insurer is financially viable by verifying it has a surplus of \$50 million on a company or pooled basis; maintains surplus, reserves and reinsurance sufficient to cover two 200-year probable maximum hurricane losses in a single hurricane season; and maintains an A.M. Best Financial Strength rating of “A-” or better.

The policy offered by the surplus lines carrier must provide similar coverage to the Citizens policy and outline any substantial differences in coverage between the existing policy and the proposed surplus lines policy. The surplus lines carrier must also notify the policyholder that surplus lines policies are not covered by the Florida Insurance Guaranty Association.

#### **Citizens Eligibility – Requirement to Purchase National Flood Insurance Program Coverage**

If property is located in the Special Flood Hazard Area as defined by the National Flood Insurance Program (NFIP), a Citizens applicant or policyholder must maintain a separate flood insurance policy that has coverage limits for the building and contents equal to those provided under the Corporations’ policy, subject to the maximum limits available under the National Flood Insurance Program. The requirement does not apply to tenants or condominium unit owners above the ground floor, a Citizens policy that excludes wind and hail coverage, a risk not eligible for flood coverage under the NFIP, or a mobile home located more than 2 miles from open water (ocean, gulf, bay, river, or the intracoastal waterway). The requirement to maintain flood insurance applies to new Citizens policies issued on or after January 1, 2012 and policies renewed on or after January 1, 2013.

#### **Citizens Eligibility – Cessation of New Commercial Nonresidential Policies**

Citizens will cease accepting applications and issuing new policies for commercial nonresidential insurance once the bill becomes law. Current commercial nonresidential policies will remain in effect.

#### **Citizens Eligibility – Cessation of Coverage for New Structures within Coastal Construction Control Line**

Structures that obtain a construction permit on or after June 1, 2011, that are located seaward of the coastal construction control line shall be ineligible for Citizens coverage.

## **Citizens Rates**

The bill provides a statement of legislative intent that Citizens coverage be actuarially determined and not competitive with rates in the admitted voluntary market. Citizens rates should be those of a residual market mechanism that provides insurance only when it cannot be procured in the voluntary market. A Citizens rate filing made on or after July 1, 2011 must conform to the following requirements:

- *Mandatory Rate Increase* – Citizens must implement a rate increase each year for each residential line of business it writes of up to 20 percent by territory and 25 percent for any single policy. The mandatory rate increase expires January 1, 2015, and does not apply to rates for sinkhole coverage or costs for the purchase of private reinsurance. Under current law, Citizens must implement a yearly rate increase that does not exceed 10 percent for any single policyholder.
- *Annual Rate Filing* – Citizens must file its recommended rates with the Office of Insurance Regulation at least annually.
- *Industry Expense Equalization Factor* – Citizens must develop its rates using an industry expense equalization factor. The factor is designed to include within Citizens' rates standard insurance industry ratemaking expense provisions. The factor must include:
  - a catastrophe risk load;
  - a provision for taxes;
  - a market provision for reinsurance costs; and
  - an industry expense provision for general expenses, acquisition expenses, and commissions.
- *OIR Establishment of Rates* – The OIR must consider the recommended rates and issue a final order establishing the rates within 45 days after they are filed. Citizens may not pursue an administrative challenge or judicial review of the OIR's final order.
- *Prohibition Against Reducing Rates* – Citizens is prohibited from reducing rates.
- *Surcharge on Structures Without Opening Protection* – Effective October 1, 2011, Citizens may impose a premium surcharge on residential structures located within the wind-borne debris region that do not have opening protections (i.e. shutters) that are required by the Florida Building Code. The surcharge is not subject to any restrictions contained in the Citizens statute or the Rating Law (s. 627.062, F.S.).

The bill deletes the requirement that the public hurricane loss projection model must serve as the minimum benchmark for determining the windstorm portion of Citizens' rates. The bill also deletes provisions related to the current 10 percent mandatory rate increase, including a provision that sunsets the mandatory rate increase once Citizens has implemented actuarially sound rates for any line of business.

## **Citizens Coverage – Elimination of HO-3 Homeowners Policies**

Citizens will not offer or renew HO-3 homeowners policies as of December 31, 2012. Instead, Citizens must offer a policy similar to what is available in the private insurance market under an HO-3, HO-4, or HO-6 policy. The prohibition on HO-3 coverage will result in Citizens using policy forms that provide coverage for fewer perils.

The HO-3 policy is an “all perils” homeowners policy that provides coverage to the structure for damage caused by any peril that is not specifically excluded from coverage and provides broad “named perils” coverage for damage to personal property. The HO-4 policy is a tenant’s (renter’s) insurance policy that provides “named peril” coverage for the personal property of tenants. The HO-6 policy is a condominium unit owner’s policy that provides broad “named peril” coverage for personal property and building components in which the policyholder has an insurable interest.

If Citizens replaces the HO-3 policy with a “named perils” policy form, it will make it more difficult for policyholders to prove they have sustained a covered loss. One of the key differences between an “all perils” policy and a “named perils” deals with which party has the burden of proof regarding whether the loss was caused by a covered peril. When property is insured by an all perils policy, the insurer has the burden of proof to show that the cause of damage was a peril that is excluded by the policy. However, when property is insured by a “named perils” policy, the policyholder has the burden of proving that the cause of damage was a peril for which the policy provides coverage.

### **Citizens Coverage – Sinkholes**

The bill requires Citizens to offer sinkhole coverage. New or renewal Citizens policies effective on or after February 1, 2012, that insure sinkholes will not include coverage for losses directly or indirectly caused by sinkhole activity to appurtenant structures (attached structures), driveways, sidewalks, decks, or patios. Citizens may provide notice of the change to current policies by including a notice of coverage change with the policy renewal. Any payment for sinkhole loss tendered by Citizens must be dedicated entirely to repairing the structure or remediation of the land, regardless of whether to payment is made pursuant to the contract, mediation, neutral evaluation, appraisal, arbitration, settlement or litigation.

### **Citizens Coverage – Cessation of Coverage for Screen Enclosures, Detached Structures, and Specified Items of Personal Property.**

All Citizens policies issued or renewed on or after February 1, 2012, will not provide coverage for attached or detached screen enclosures. Personal residential policies that are new or renewed on or after February 1, 2013, will not provide coverage for detached structures that are separated from the dwelling. Coverage will not be provided for a structure connected to the dwelling by a fence, utility line, or similar connection.

Personal residential policies effective on or after February 1, 2013, will not provide coverage for the following items of personal property: watercraft, trailers, jewelry, furs, firearms, silverware, business property on premises, business property away from premises, or grave markers.

### **Citizens Deficit Assessments – Citizens Policyholder Surcharge**

Citizens is prohibited from levying a regular assessment for a particular year’s deficit until it has first levied the full amount of the Citizens policyholder surcharge (up to 15 percent of premium for each of the three Citizens accounts). The policyholder surcharge must be paid upon renewal, cancellation or termination of the policy. New Citizens policies issued within 12 months after the

levy of the surcharge or the period of time necessary to collect the surcharge must also require payment of the policyholder surcharge.

### **Citizens Deficit Assessments – Emergency Assessments**

The bill requires Citizens policyholders to pay Citizens emergency assessments that are 1.5 times the emergency assessment levied on subject lines of business in the private insurance market.

### **Citizens Deficit Assessments - Notice of Surcharge and Assessment Liability**

As of January 1, 2012, an agent seeking to place coverage with Citizens must obtain a the applicant's signature on a written acknowledgement form notifying the applicant of the potential liability for surcharges and assessments placed on Citizens policyholders. If the acknowledgement form states that the policyholder understands that:

- If Citizens sustains a deficit, the policyholder could be subject to surcharges as high as 45 percent of premium.
- The policyholder is subject to emergency assessments to the same extent as policyholders of other insurance companies, or a different amount as imposed by the Legislature.
- Citizens is not supported by the full faith and credit of the state.

Citizens must maintain a copy of the signed acknowledgment form and send a copy to the policyholder upon the first renewal. The signed acknowledgment form creates a conclusive presumption the policyholder understood and accepted his or her potential surcharge and assessment liability.

### **Exemption from Bad Faith Liability and Extracontractual Damages**

The bill clarifies existing law that Citizens is not liable for any claim for bad faith liability and that the Citizens statute and other provisions of law do not create a cause of action for bad faith or a claim for extracontractual damages. The bill states that the exemption from bad faith liability is part of the immunity from liability granted to the corporation and its agents, employees, board members, committee members and the OIR for actions taken by them in the performance of their duties or responsibilities under the Citizens statute. The bad faith exemption is premised on the fact that Citizens is a governmental entity that serves a public purpose.

### **Exemption from Attorney's Fee Liability**

The bill also exempts Citizens from liability to pay the attorney's fees of policyholders and beneficiaries in legal actions that allege a breach of contract or seek payment of policy benefits. Under current law, Citizens is subject to pay attorney's fees pursuant to s. 627.428, F.S.

### **Public Adjuster Prohibition**

Policyholders are prohibited from engaging the services of a public adjuster with respect to any claim incurred under a policy issues by Citizens until Citizens has tendered an offer on the claim. The public adjuster's fee must be based on a reasonable hourly rate and may not be based on a

contingency basis based upon a percentage of the claim amount. The public adjuster's total fee may not exceed 5 percent of the additional amount paid to the policyholder in excess of the Citizens offer on the claim. The limitation on retaining a public adjuster is a condition of coverage and made in recognition of Citizens' status as a government entity.

### **Agents – Eligibility for Appointment**

Effective January 1, 2012, an insurance agent may only be appointed to be a licensed agent for Citizens if the agent holds an appointment with an authorized insurer that is actually writing personal lines residential property coverage in the state. Section 626.015(3), F.S., defines an "appointment" as authority given by an insurer or employer to a licensee to transact insurance or adjust claims on its behalf. Current law only requires that the agent have an appointment with a private market insurer that is currently writing coverage at the time of the agent's appointment with Citizens. Under the bill, a licensed Citizens agent can no longer represent it if the private market company that appointed the agent stops actively writing property coverage in Florida.

### **Agents – Grounds for Termination**

Citizens must immediately terminate an agent's appointment to represent it if the Department of Financial Services determines that the agent violated s. 626.9541(1)(h), F.S. Section 626.9541(1)(h), F.S., prohibits unlawful rebates and defines such acts as an unfair insurance trade practice.

### **Citizens Governance – Outsourcing of Citizens Policy Issuance and Service Functions**

The Citizens board of directors must commission an independent third-party consultant with expertise in insurance company management to issue a report that makes recommendations on the relative costs and benefits of outsourcing Citizens policy issuance and service functions to private servicing carriers or similar entities in the private market. The consultant must consider how other residual markets outsource appropriate functions or use servicing carriers. The report must be completed by February 1, 2012.

The board must develop a plan to implement the report and submit the plan to the Financial Services Commission. The commission has 30 days to review the plan and make any revisions. If the Commission approves the plan, the Citizens board of directors must begin implementing it by January 1, 2013.

### **Citizens Governance – Market Accountability Advisory Committee**

The bill expands the function of the Market Accountability Advisory Committee to include providing advice in issues regarding agent appointments and compensation. Accordingly, the committee will include issues relating to producer compensation and agency agreements within the report it provides during each Citizens board meeting. The bill also clarifies that members of the committee are must be appointed for a 3-year term, but are not required to serve the entire term.

### **Citizens Governance – Conflict of Interest Procedures for Citizens Board Members**

The bill provides procedures for board members who have a conflict of interest regarding a particular matter. A Citizens board member may not vote on any measure that would inure to the gain or loss of the board member; the board member's corporate principal or the parent or subsidiary of the corporate principal; or the relative or business associate of the board member. A board member with a conflict must state his or her interest in the matter prior to the vote being taken. The board member must also provide written disclosure of the conflict within 15 days after the vote, and the disclosure must be included in the minutes of the board meeting and available as a public record.

### **Repeal of Requirement to Reduce Citizens High-Risk Area**

Risks located within Citizens' high-risk area are eligible for wind-only coverage from the corporation. The bill deletes the requirement that the Citizens board of directors annually report to the Legislature the reduction or increase in the 100-year probable maximum loss attributable to the combined PML of wind-only coverage and the Citizens quota-share program, when compared to the 100-year PML for the Florida Windstorm Underwriting Association as of February 2001 (the benchmark PML). The bill also deletes requirements that Citizens reduce the boundaries of the high-risk area. As of December 1, 2010, current law requires the Citizens board of directors to reduce the boundaries of the high-risk to the extent necessary to reduce the probably maximum loss attributable to wind-only coverages and the quota-share program to 25 percent below the benchmark PML. As of February 1, 2015, the high risk area boundaries must be further reduced to create a 50 percent PML reduction below the benchmark PML.

### **Repeal of the Citizens Quota Share Program**

The bill deletes statutory authorization for Citizens to enter into quota share primary insurance agreements, as defined in s. 627.4025(2)(a), F.S., to provide hurricane coverage for risks eligible for coverage in the Citizens high-risk account. Quota share insurance is an agreement between Citizens and a private market insurer to provide insurance coverage in specified percentages.

**Section 1** amends s. 627.0655, F.S., to eliminate the ability of insurers to offer multi-line insurance discounts for insurance placed with Citizens or a "take out" policy from Citizens that is assumed by a different carrier after January 1, 2013.

**Section 2** amends s. 627.351 (6), F.S., to make technical conforming changes related to the statutory changes in the bill.

**Section 3** amends s. 627.3511(4), F.S., to make technical and conforming changes related to the statutory changes in the bill.

**Section 4** provides that this act is effective upon becoming a law.



**IV. Constitutional Issues:**

## A. Municipality/County Mandates Restrictions:

None.

## B. Public Records/Open Meetings Issues:

None.

## C. Trust Funds Restrictions:

None.

**V. Fiscal Impact Statement:**

## A. Tax/Fee Issues:

None.

## B. Private Sector Impact:

The change is intended to create an additional incentive for private market insurers to write property insurance and for agents to attempt to place property insurance with private market carriers.

Citizens policyholders will be subject to a yearly rate increase of no more than 20% per territory and 25% per policy, not including rate increases attributable to sinkhole coverage or the purchase of private reinsurance. The requirement that Citizens use an industry expense equalization factor will also increase Citizens rates. The rate-increase requirements are intended to return Citizens to its original intended purpose as the property insurer of last resort. The rate increases should also improve the ability of Citizens to pay catastrophe claims out of its surplus and accelerate the depopulation of its policies into the private insurance market.

Citizens policyholders will be subject to emergency assessments levied by Citizens that are 1.5 times the emergency assessment levied on policyholder in the private market. The provision ensures that Citizens policyholders will face greater liability for such assessments than other policyholders.

Citizens policies coverage will generally be more restrictive under the bill. Citizens is prohibited from issuing a standard HO-3 policy that provides coverage for "all-perils" that are not specifically excluded from the policy. The bill also eliminates personal residential coverage for detached structures, specified items personal property, and screened enclosures, appurtenant structures, sidewalks, and patios.

All structures with a value of \$1 million or more will be ineligible for Citizens coverage beginning in 2012. Policyholders in the personal lines account will be ineligible for

Citizens coverage in 2014 if the structure has a value of \$750,000 or more. In 2016, structures valued at \$500,000 or more are ineligible. The owners of these properties will be forced to obtain coverage from the admitted insurance market or a largely unregulated surplus lines insurance carrier.

The prohibition on million dollar structures will also affect Citizens policyholders owning residences valued at over \$1 million who complied with s. 627.736(a)5., F.S., which requires owners of \$750,000 homes in the wind-borne debris region to purchase opening protections (i.e. shutters) in order to remain eligible as of January 1, 2009. Such policyholders will now be ineligible for Citizens if the residence is valued at \$1 million or more. Policyholders for structures that in the wind borne debris region for Citizens that do not have opening protections installed will be subject to a surcharge.

Insureds located within a Special Flood Hazard Area as defined by the National Flood Insurance Program will be required to maintain a separate flood insurance policy as a condition of Citizens coverage. Such insureds will have additional protection from flood damage, which is excluded under the Citizens policy, but will have to incur additional cost.

Citizens cannot insure new structures seaward of the coastal construction control line that are permitted after June 1, 2011. This should discourage development of beachfront properties that are extremely vulnerable to hurricane loss.

Business owners who cannot procure commercial property insurance coverage in the admitted private insurance market will be ineligible to obtain such coverage from Citizens. This will likely necessitate the purchase of insurance from a nonadmitted surplus lines insurance carrier.

Authorization of surplus lines carriers to take part in Citizens depopulation programs may help reduce the number of policies in Citizens and reduce its liability for losses due to a catastrophic event. However, policyholders of surplus lines carriers will not be afforded protection in the event the surplus lines carrier is insolvent because the Florida Insurance Guaranty Association does not cover surplus lines policies.

Citizens must provide sinkhole coverage under the bill, which will ensure that such coverage is available in the private market. Citizens, however, will only provide benefits for sinkhole losses if such monies are used to repair the structure and remediate the sinkhole. This requirement should help eliminate frivolous sinkhole claims from policyholders who are seeking a cash payout rather than the means to repair their properties.

**C. Government Sector Impact:**

Citizens Property Insurance Corporation estimates that implementation of the provisions of this bill will result in an additional \$210 million in premiums collected. There are also costs associated with implementing the coverage changes. Citizens will likely incur

expenses in replacing its current HO-3 homeowners' insurance policy with an alternative policy form that is similar to coverage available in the private market.

Citizens may benefit from outsourcing its policy issuance and service functions to private servicing carriers or similar entities if the private market can effectively perform these functions at a lower cost.

Clarification of Citizens existing exemption from bad faith liability will help ensure that the courts do not apply the civil remedy statute or common law bad faith liability to claims handled by Citizens.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Additional Information:**

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

**CS by Banking and Insurance Committee on March 29, 2011**

The committee substitute contains the following changes:

- Discontinues the statutory authorization for companies to give a multi-policy discount for a homeowner's policy that is insured by Citizens or taken out of Citizens by a different carrier.
- Prohibits a policyholder from hiring a public adjuster until Citizens has tendered an offer of a claim.
- Places limits on public adjuster compensation for claims under a Citizens policy.
- Prohibits Citizens from insuring structures seaward of the coastal construction control line that are permitted after June 1, 2011.
- Specifies that Citizens will not cover detached structures separated from the dwelling.
- Specifies that Citizens will not cover certain items of personal property.
- Requires Citizens to offer sinkhole coverage.
- Prohibits Citizens from making payments for sinkhole loss unless the funds are used to repair the structure and remediate sinkhole conditions.
- Specifies that Citizens is not liable for attorney's fees under s. 627.428, F.S.
- Authorizes surplus lines insurers to participate in Citizens depopulation, take-out, and keep-out programs.
- Authorizes Citizens to levy a surcharge on personal lines residential properties located within the wind-borne debris region that lack opening protections.

B. Amendments:

None.

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

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